

# CONDUCT RULES

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**2000. BUSINESS CONDUCT****2100. GENERAL STANDARDS****2110. Standards of Commercial Honor and Principles of Trade**

A member, in the conduct of his business, shall observe high standards of commercial honor and just and equitable principles of trade.

**Cross References -**

- IM-1000-1, Filing of Misleading Information as to Membership or Registration
- IM-1000-3, Failure to Register Personnel
- IM-2110-2, Trading Ahead of Customer Limit Order
- IM-2110-3, Front Running Policy
- IM-2230, Nasdaq InterMarket Confirmations
- IM-2310-2, Fair Dealing with Customers
- IM-2440, Mark Up Policy
- IM-3310, Manipulative and Deceptive Quotations
- IM-10100, Failure to Act Under Provisions of Code of Arbitration Procedure
- IM-11110, Refusal to Abide by Rulings of the Committee

**Selected SEC Decisions**

Albert P. Fosha, SEC Rel. No. 34-22815 (1986).  
 C. Brock Lippitt, Thomas M. Svalberg and Gerald B. Fitzgerald, SEC Rel. No. 34-23495 (1986).  
 Robert J. Jautz, SEC Rel. No. 34-24346 (1987).  
 Robert S.C. Peterson, Inc. and Robert S.C. Peterson, SEC Rel. No. 34-24688 (1987).  
 Rita Delaney, SEC Rel. No. 34-25119 (1987).  
 Gary D. Cohee, SEC Rel. No. 34-25210 (1987).  
 Traiger Energy Investments and Michael A. Traiger, SEC Rel. No. 34-25306 (1988).  
 E.F. Hutton & Co., Inc. (n/k/a) Shearson Lehman Hutton, Inc., SEC Rel. No. 34-25587 (1988).  
 Stephen M. Carter, SEC Rel. No. 34-26264 (1988).  
 Cosse International Securities, Inc. and Charles B. Cosse, SEC Rel. No. 34-26424 (1989).  
 L.C. Thomas and Stephen V. Wallace, SEC Rel. No. 34-26530 (1989).  
 Stanley D. Gardenswartz, SEC Rel. No. 34-27194 (1989).  
 Walter Capital Corp. and Frank R. Grillo, SEC Rel. No. 34-27536 (1989).

**IM-2110-1. [Reserved]****IM-2110-2. Trading Ahead of Customer Limit Orders****(a) General Application**

To continue to ensure investor protection and enhance market quality, Nasdaq is issuing an interpretation to its Rules dealing with member firms' treatment of their customer limit orders in Nasdaq securities. This interpretation, which is applicable from 9:30 a.m. to 6:30 p.m. Eastern Time, will require members acting as market makers to handle their customer limit orders with all due care so that market makers do not "trade ahead" of those limit orders. Thus, members acting as market makers that handle customer limit orders, whether received from their own customers or from another member, are prohibited from trading at prices equal or superior to that of the limit order without executing the limit order.

Nasdaq Rule 2110 states that:

A member, in the conduct of his business, shall observe high standards of commercial honor and just and equitable principles of trade.

Rule 2320, the Best Execution Rule, states that:

In any transaction for or with a customer, a member and persons associated with a member shall use reasonable diligence to ascertain the best inter-dealer market for the subject security and buy or sell in such a market so that the resultant price to the customer is as favorable as possible to the customer under prevailing market conditions.

#### **Interpretation**

The following is an interpretation of Rule 2110 :

A member firm that accepts and holds an unexecuted limit order from its customer (whether its own customer or a customer of another member) in a Nasdaq-listed security and that continues to trade the subject security for its own market-making account at prices that would satisfy the customer's limit order, without executing that limit order, shall be deemed to have acted in a manner inconsistent with just and equitable principles of trade, in violation of Rule 2110, provided that, a member firm may negotiate specific terms and conditions applicable to the acceptance of limit orders only with respect to limit orders that are: (a) for customer accounts that meet the definition of an "institutional account" as that term is defined in Rule 3110(c)(4); or (b) 10,000 shares or more, unless such orders are less than \$100,000 in value. Nothing in this interpretation, however, requires members to accept limit orders from any customer.

Nasdaq wishes to emphasize that members may not trade ahead of their customer limit orders in their market-making capacity even if the member had in the past fully disclosed the practice to its customers prior to accepting limit orders. Nasdaq believes that, pursuant to Rule 2110, members accepting and holding unexecuted customer limit orders owe certain duties to their customers and the customers of other member firms that may not be overcome or cured with disclosure of trading practices that include trading ahead of the customer's order. The terms and conditions under which institutional accounts or appropriately sized customer limit orders are accepted must be made clear to customers at the time the order is accepted by the firm so that trading ahead in the firm's market making capacity does not occur. For purposes of this interpretation, a member that controls or is controlled by another member shall be considered a single entity so that if a customer's limit order is accepted by one affiliate and forwarded to another affiliate for execution, the firms are considered a single entity and the market making unit may not trade ahead of that customer's limit order.

Nasdaq also wishes to emphasize that all members accepting customer limit orders owe those customers duties of "best execution" regardless of whether the orders

are executed through the member's market making capacity or sent to another member for execution. As set out above, the Best Execution Rule requires members to use reasonable diligence to ascertain the best inter-dealer market for the security and buy or sell in such a market so that the price to the customer is as favorable as possible under prevailing market conditions. Nasdaq emphasizes that order entry firms should continue to routinely monitor the handling of their customers' limit orders regarding the quality of the execution received.

**(b) Exclusion for Limit Orders that are Marketable at Time of Receipt**

Nasdaq recognizes the functional equivalency of marketable limit orders and market orders. Accordingly, it has adopted the following interpretation. IM-2110-2 shall not apply to a customer limit order if the limit order is marketable at the time it is received by a market maker. These orders shall be treated as market orders for purposes of determining execution priority; however, these orders must continue to be executed at their limit price or better.

The exclusion for marketable customer limit orders from the general application of IM-2110-2 is limited solely to customer limit orders that are marketable when received by a market maker. If a customer limit order is not marketable when received by a market maker, the limit order must be accorded the full protections of IM-2110-2. In addition, if the limit order was marketable when received and then becomes non-marketable, once the limit order becomes non-marketable it must be accorded the full protections of IM-2110-2.

The following scenario illustrates the application of the exclusion. The market in XYZ stock is 25 bid - 25 1/16 ask, the volume of trading in XYZ stock is extremely active, and Market Maker A ("MMA") has a queue of market orders to buy and sell. Assume the following order receipt scenario. Each sell market order in the queue is for 1,000 shares and there are no special conditions attached to the orders. MMA then receives a customer limit order to sell 1,000 shares at 25. The customer limit order is marketable at the time it is received by MMA. MMA hits another market maker's bid at 25 for 1,000 shares. Normally, IM-2110-2 would require that the customer limit order be executed contemporaneously with the order that triggered the obligation under IM2110-2. However, because the marketable limit order and the market orders should be treated as functionally equivalent in determining execution priority, the marketable customer limit order shall not be given execution priority over the market orders that were already in the queue. When the limit order is executed, however, it must be executed at the limit price or better.

In addition, if in the scenario just described the limit order does not get executed and the inside market in XYZ becomes 24 7/16 bid, the market maker would have to protect the limit order as required by IM 2110-2 if the market maker trades at the limit order price or better.

Selected NASD Notices to Members: 95-43, 95-67.

**IM-2110-3. Front Running Policy**

It shall be considered conduct inconsistent with just and equitable principles of trade for a member or person associated with a member, for an account in which such member or person associated with a member has an interest, for an account with respect to which such member or person associated with a member exercises investment discretion, or for certain customer accounts, to cause to be executed:

(a) an order to buy or sell an option when such member or person associated with a member causing such order to be executed has material, non-public market information concerning an imminent block transaction in the underlying security, or when a customer has been provided such material non-public market information by the member or any person associated with a member; or

(b) an order to buy or sell an underlying security when such member or person associated with a member causing such order to be executed has material, non-public market information concerning an imminent block transaction in an option overlying that security, or when a customer has been provided such material, non-public market information by the member or any person associated with a member; prior to the time information concerning the block transaction has been made publicly available.

The violative practice noted above may include transactions which are executed based upon knowledge of less than all of the terms of the block transaction, so long as there is knowledge that all of the material terms of the transaction have been or will be agreed upon imminently.

The general prohibitions stated above shall not apply to transactions executed by member participants in automatic execution systems in those instances where participants must accept automatic executions.

These prohibitions also do not include situations in which a member or person associated with a member receives a customer's order of block size relating to both an option and the underlying security. In such cases, the member and person associated with a member may position the other side of one or both components of the order. However, in these instances, the member and person associated with a member would not be able to cover any resulting proprietary position(s) by entering an offsetting order until information concerning the block transaction involved has been made publicly available.

The application of this front running policy is limited to transactions that are required to be reported on the last sale reporting systems administered by Nasdaq, Consolidated Tape Association (CTA), or Option Price Reporting Authority (OPRA). Information as to a block transaction shall be considered to be publicly available when it has been disseminated via the tape or high speed communications line of one of those systems or of a third-party news wire service.

A transaction involving 10,000 shares or more of an underlying security or options covering such number of shares is generally deemed to be a block transaction, although a transaction of less than 10,000 shares could be considered a block transaction in appropriate cases. A block transaction that has been agreed upon does not lose its identity as such by arranging for partial executions of the full transaction in portions which themselves are not of block size if the execution of the full transaction may have a material impact on the market. In this situation, the requirement that information concerning the block transaction be made publicly available will not be satisfied until the entire block transaction has been completed and publicly reported.

Selected NASD Notices to Members: 96-66.

#### **IM-2110-4. Trading Ahead of Research Reports**

Nasdaq, under its statutory obligation to protect investors and enhance market quality, is issuing an interpretation to the Rules regarding a member firm's trading activities that occur in anticipation of a firm's issuance of a research report regarding a security. Nasdaq is concerned with activities of member firms that purposefully establish or adjust the firm's inventory position in Nasdaq-listed securities, other exchange-listed securities traded pursuant to unlisted trading privileges, or a derivative security based primarily on a specific Nasdaq or other exchange-listed security in anticipation of the issuance of a research report in that same security. For example, a firm's research department may prepare a research report recommending the purchase of a particular Nasdaq-listed security. Prior to the publication and dissemination of the report, however, the trading department of the member firm might purposefully accumulate a position in that security to meet anticipated customer demand for that security. After the firm had established its position, the firm would issue the report, and thereafter fill customer orders from the member firm's inventory positions.

Nasdaq believes that such activity is conduct which is inconsistent with just and equitable principles of trade, and not in the best interests of the investors. Thus, this interpretation prohibits a member from purposefully establishing, creating or changing the firm's inventory position in a Nasdaq-listed security, other exchange-listed security traded pursuant to unlisted trading privileges, or a derivative security related to the underlying equity security, in anticipation of the issuance of a research report regarding such security by the member firm.

Rule 2110 states that:

A member in the conduct of its business, shall observe high standards of commercial honor and just and equitable principles of trade.

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Trading activity purposefully establishing, increasing, decreasing, or liquidating a position in a Nasdaq security, other exchange-listed security traded pursuant to unlisted

trading privileges, or a derivative security based primarily upon a specific Nasdaq or other exchange-listed security, in anticipation of the issuance of a research report in that security is inconsistent with just and equitable principles of trade and is a violation of Rule 2110.

For purposes of this interpretation, a "purposeful" change in the firm's inventory position means any trading activities undertaken with the intent of altering a firm's position in a security in anticipation of accommodating investor interest once the research report has been published. Hence, the interpretation does not apply to changes in an inventory position related to unsolicited order flow from a firm's retail or broker/dealer client base or to research done solely for in-house trading and not in any way used for external publication.

Under this interpretation, Nasdaq recommends, but does not require, that member firms develop and implement policies and procedures to establish effective internal control systems and procedures that would isolate specific information within research and other relevant departments of the firm so as to prevent the trading department from utilizing the advance knowledge of the issuance of a research report. Firms that choose not to develop "Chinese Wall" procedures bear the burden of demonstrating that the basis for changes in inventory positions in advance of research reports was not purposeful.

Selected NASD Notices to Members: 95-75.

#### **IM-2110-5. Anti-Intimidation/Coordination**

Nasdaq is issuing this interpretation to codify a longstanding policy. It is conduct inconsistent with just and equitable principles of trade for any member or person associated with a member to coordinate the prices (including quotations), trades, or trade reports of such member with any other member or person associated with a member; to direct or request another member to alter a price (including a quotation); or to engage, directly or indirectly, in any conduct that threatens, harasses, coerces, intimidates, or otherwise attempts improperly to influence another member or person associated with a member. This includes, but is not limited to, any attempt to influence another member or person associated with a member to adjust or maintain a price or quotation, whether displayed on any automated system operated by Nasdaq, or otherwise, or refusals to trade or other conduct that retaliates against or discourages the competitive activities of another market maker or market participant. Nothing in this interpretation respecting coordination of quotes, trades, or trade reports shall be deemed to limit, constrain, or otherwise inhibit the freedom of a member or person associated with a member to:

- (1) set unilaterally its own bid and ask in any Nasdaq security, the prices at which it is willing to buy or sell any Nasdaq security, and the quantity of shares of any Nasdaq security that it is willing to buy or sell;
- (2) set unilaterally its own dealer spread, quote increment, or quantity of shares for its quotations (or set any relationship between or among its dealer

spread, inside spread, or the size of any quote increment) in any Nasdaq security;

(3) communicate its own bid or ask, or the prices at or the quantity of shares in which it is willing to buy or sell any Nasdaq security to any person, for the purpose of exploring the possibility of a purchase or sale of that security, and to negotiate for or agree to such purchase or sale;

(4) communicate its own bid or ask, or the price at or the quantity of shares in which it is willing to buy or sell any Nasdaq security, to any person for the purpose of retaining such person as an agent or subagent for the member or for a customer of the member (or for the purpose of seeking to be retained as an agent or subagent), and to negotiate for or agree to such purchase or sale;

(5) engage in any underwriting (or any syndicate for the underwriting) of securities to the extent permitted by the federal securities laws;

(6) take any unilateral action or make any unilateral decision regarding the market makers with which it will trade and the terms on which it will trade unless such action is prohibited by the second and third sentences of this Interpretation; and

(7) deliver an order to another member for handling,

provided, however, that the conduct described in (1) through (7) is otherwise in compliance with all applicable law.

#### **IM-2110-6. Confirmation of Callable Common Stock**

Any member providing a customer confirmation pursuant to SEC Rule 10b-10 in connection with any transaction in callable common stock shall disclose on such confirmation that:

- the security is callable common stock; and
- a customer may contact the member for more information concerning the security

#### **2120. Use of Manipulative, Deceptive or Other Fraudulent Devices**

No member shall effect any transaction in, or induce the purchase or sale of, any security by means of any manipulative, deceptive or other fraudulent device or contrivance.

*Cross Reference - IM-2310-2, Fair Dealing with Customers*

#### **2130. Nasdaq Ownership Restriction**

(a) No member or person associated with a member shall be the beneficial owner of greater than five percent (5%) of the then-outstanding shares of Common Stock of The Nasdaq Stock Market, Inc.

(b) For purposes of this rule, any calculation of the number of shares of common stock outstanding at any particular time shall be made in accordance with the last sentence of SEC Rule 13d-3(d)(1)(i)(D). The term "beneficial owner" shall have the meaning set forth in Article Fourth, Paragraph C of Nasdaq's Restated Certificate of Incorporation.

## **2200. COMMUNICATIONS WITH CUSTOMERS AND THE PUBLIC**

### **2210. Communications with the Public**

#### **(a) Definitions- Communications with the public shall include:**

(1) Advertisement--For purposes of this Rule and any interpretation thereof, "advertisement" means material published, or designed for use in, a newspaper, magazine or other periodical, radio, television, telephone or tape recording, videotape display, signs or billboards, motion pictures, telephone directories (other than routine listings), electronic or other public media.

(2) Sales Literature--For purposes of this Rule and any interpretation thereof, "sales literature" means any written or electronic communication distributed or made generally available to customers or the public, which communication does not meet the foregoing definition of "advertisement." Sales literature includes, but is not limited to, circulars, research reports, market letters, performance reports or summaries, form letters, telemarketing scripts, seminar texts, and reprints or excerpts of any other advertisement, sales literature or published article.

(3) Correspondence--For purposes of this Rule and any interpretation thereof, "correspondence" means any written or electronic communication prepared for delivery to a single current or prospective customer, and not for dissemination to multiple customers or the general public.

*Cross Reference - Rules Concerning Review and Endorsement of Correspondence are Found in paragraph (d) to Rule 3010.*

#### **(b) Approval and Recordkeeping**

(1) Each item of advertising and sales literature shall be approved by signature or initial, prior to use or filing with the NASD, by a registered principal of the member. This requirement may be met, only with respect to corporate debt and equity securities that are the subject of research reports as that term is defined in Rule 472 of the New York Stock Exchange, by the signature or initial of a supervisory analyst approved pursuant to Rule 344 of the New York Stock

Exchange.

(2) A separate file of all advertisements and sales literature, including the name(s) of the person(s) who prepared them and/or approved their use, shall be maintained for a period of three years from the date of each use.

**(c) Reserved**

**(d) Standards Applicable to Communications with the Public**

**(1) General Standards**

(A) All member communications with the public shall be based on principles of fair dealing and good faith and should provide a sound basis for evaluating the facts in regard to any particular security or securities or type of security, industry discussed, or service offered. No material fact or qualification may be omitted if the omission, in the light of the context of the material presented, would cause the communications to be misleading.

(B) Exaggerated, unwarranted or misleading statements or claims are prohibited in all public communications of members. In preparing such communications, members must bear in mind that inherent in investment are the risks of fluctuating prices and the uncertainty of dividends, rates of return and yield, and no member shall, directly or indirectly, publish, circulate or distribute any public communication that the member knows or has reason to know contains any untrue statement of a material fact or is otherwise false or misleading.

(C) When sponsoring or participating in a seminar, forum, radio or television interview, or when otherwise engaged in public appearances or speaking activities which may not constitute advertisements, members and persons associated with members shall nevertheless follow the standards of paragraphs (d) and (f) of this Rule.

(D) In judging whether a communication or a particular element of a communication may be misleading, several factors should be considered, including but not limited to:

(i) the overall context in which the statement or statements are made. A statement made in one context may be misleading even though such a statement could be appropriate in another context. An essential test in this regard is the balance of treatment of risks and potential benefits.

(ii) the audience to which the communication is directed. Different levels of explanation or detail may be necessary

depending on the audience to which a communication is directed, and the ability of the member given the nature of the media used, to restrict the audience appropriately. If the statements made in a communication would be applicable only to a limited audience, or if additional information might be necessary for other audiences, it should be kept in mind that it is not always possible to restrict the readership of a particular communication.

(iii) the overall clarity of the communication. A statement or disclosure made in an unclear manner can result in a lack of understanding of the statement, or in a serious misunderstanding. A complex or overly technical explanation may be more confusing than too little information. Likewise material disclosure relegated to legends or footnotes may not enhance the reader's understanding of the communication.

## **(2) Specific Standards**

In addition to the foregoing general standards, the following specific standards apply:

(A) Necessary Data. Advertisements and sales literature shall contain the name of the member, unless such advertisements and sales literature comply with paragraph (f). Sales literature shall contain the name of the person or firm preparing the material, if other than the member, and the date on which it is first published, circulated or distributed. If the information in the material is not current, this fact should be stated.

(B) Recommendations.

(i) In making a recommendation in advertisements and sales literature, whether or not labeled as such, a member must have a reasonable basis for the recommendation and must disclose any of the following situations which are applicable:

a. that the member usually makes a market in the securities being recommended, or in the underlying security if the recommended security is an option, or that the member or associated persons will sell to or buy from customers on a principal basis;

b. that the member and/or its officers or partners own options, rights or warrants to purchase any of the securities of the issuer whose securities are recommended, unless the extent of such ownership is nominal;

c. that the member was manager or co-manager of a public offering of any securities of the recommended issuer within the last three years.

(ii) The member shall also provide, or offer to furnish upon request, available investment information supporting the recommendation. Recommendations on behalf of corporate equities must provide the price at the time the recommendation is made.

(iii) A member may use material referring to past recommendations if it sets forth all recommendations as to the same type, kind, grade or classification of securities made by a member within the last year. Longer periods of years may be covered if they are consecutive and include the most recent year. Such material must also name each security recommended and give the date and nature of each recommendation (e.g., whether to buy or sell), the price at the time of the recommendation, the price at which or the price range within which the recommendation was to be acted upon, and indicate the general market conditions during the period covered.

(iv) Also permitted is material which does not make any specific recommendation but which offers to furnish a list of all recommendations made by a member within the past year or over longer periods of consecutive years, including the most recent year, if this list contains all the information specified in subparagraph (iii). Neither the list of recommendations, nor material offering such list, shall imply comparable future performance. Reference to the results of a previous specific recommendation, including such a reference in a follow-up research report or market letter, is prohibited if the intent or the effect is to show the success of a past recommendation, unless all of the foregoing requirements with respect to past recommendations are met.

(C) Claims and Opinions. Communications with the public must not contain promises of specific results, exaggerated or unwarranted claims or unwarranted superlatives, opinions for which there is no reasonable basis, or forecasts of future events which are unwarranted, or which are not clearly labeled as forecasts.

(D) Testimonials. In testimonials concerning the quality of a firm's investment advice, the following points must be clearly stated in advertisements or sales literature:

(i) The testimonial may not be representative of the experience of other clients.

(ii) The testimonial is not indicative of future performance or success.

(iii) If more than a nominal sum is paid, the fact that it is a paid testimonial must be indicated.

(iv) If the testimonial concerns a technical aspect of investing, the person making the testimonial must have knowledge and experience to form a valid opinion.

(E) Offers of Free Service. Any statement in communications with the public to the effect that any report, analysis, or other service will be furnished free or without any charge must not be made unless such report, analysis or other service actually is or will be furnished entirely free and without condition or obligation.

(F) Claims for Research Facilities. No claim or implication in communications with the public may be made for research or other facilities beyond those which the member actually possesses or has reasonable capacity to provide.

(G) Hedge Clauses. No cautionary statements or caveats, often called hedge clauses, may be used in communications with the public if they are misleading or are inconsistent with the content of the material.

(H) Recruiting Advertising. Advertisements in connection with the recruitment of sales personnel must not contain exaggerated or unwarranted claims or statements about opportunities in the investment banking or securities business and should not refer to specific earnings figures or ranges which are not reasonable under the circumstances.

(I) Periodic Investment Plans. Advertisements and sales literature should not discuss or portray any type of continuous or periodic investment plan without disclosing that such a plan does not assure a profit and does not protect against loss in declining markets. In addition, if the material deals specifically with the principles of dollar-cost averaging, it should point out that since such a plan involves continuous investment in securities regardless of fluctuating price levels of such securities, the investor should consider his financial ability to continue his purchases through periods of low price levels.

(J) References to Regulatory Organizations. Communications with the public shall not make any reference to membership in Nasdaq or

to registration or regulation of the securities being offered, or of the underwriter, sponsor, or any member or associated person, which reference could imply endorsement or approval by Nasdaq or any federal or state regulatory body. References to membership in Nasdaq or Securities Investors Protection Corporation shall comply with all applicable By-Laws and Rules pertaining thereto.

(K) Identification of Sources. Statistical tables, charts, graphs or other illustrations used by members in advertising or sales literature should disclose the source of the information if not prepared by the member.

(L) Claims of Tax Free/Tax Exempt Returns. Income or investment returns may not be characterized in communications with the public as tax free or exempt from income tax where tax liability is merely postponed or deferred. If taxes are payable upon redemption, that fact must be disclosed in advertisements and sales literature. References in advertisements and sales literature to tax free/tax exempt current income must indicate which income taxes apply or which do not unless income is free from all applicable taxes. For example, if income from an investment company investing in municipal bonds may be subject to state or local income taxes, this should be stated, or the illustration should otherwise make it clear that income is free from federal income tax.

(M) Comparisons. In making a comparison in advertisements or sales literature, either directly or indirectly, the member must make certain that the purpose of the comparison is clear and must provide a fair and balanced presentation, including any material differences between the subjects of comparison. Such differences may include investment objectives, sales and management fees, liquidity, safety, guarantees or insurance, fluctuation of principal and/or return, tax features, and any other factors necessary to make such comparisons fair and not misleading.

(N) Predictions and Projections. In communications with the public, investment results cannot be predicted or projected. Investment performance illustrations may not imply that gain or income realized in the past will be repeated in the future. However, for purposes of this Rule, hypothetical illustrations of mathematical principles are not considered projections of performance; e.g., illustrations designed to show the effects of dollar cost averaging, tax-free compounding, or the mechanics of variable annuity contracts or variable life policies.

#### **(e) Application of SEC Rules**

In addition to the provisions of paragraph (d) of this Rule, members' public communications shall conform to all applicable rules of the Commission, as in effect at the time the material is used.

**(f) Standards Applicable to the Use and Disclosure of the Nasdaq Member's Name**

(1) In addition to the provisions of paragraph (d) of this Rule, members' public communications shall conform to the following provisions concerning the use and disclosure of member names. The term "communication" as used herein shall include any item defined as either "advertising" or "sales literature" in paragraph (a). The term "communication" shall also include, among other things, business cards and letterhead.

**(2) General Standards**

(A) Any communication used in the promotion of a member's securities business must clearly and prominently set forth the name of the Nasdaq member. This requirement shall not apply to so-called "blind" advertisements used for recruiting personnel or to those communications meeting the provisions of paragraph (f)(3).

(B) If a non-member entity is named in a communication in addition to the member, the relationship, or lack of relationship, between the member and the entity shall be clear.

(C) If a non-member entity is named in a communication in addition to the member and products or services are identified, no confusion shall be created as to which entity is offering which products and services. Securities products and services shall be clearly identified as being offered by the member.

(D) If an individual is named in a communication containing the names of the member and a non-member entity, the nature of the affiliation or relationship of the individual with the member shall be clear.

(E) Communications that refer to individuals may not include, with respect to such individuals, references to nonexistent or self-conferred degrees or designations, nor may such communications make reference to bona fide degrees or designations in a misleading manner.

(F) If a communication identifies a single company, the communication shall not be used in a manner which implies the offering of a product or service not available from the company named.

(G) The positioning of disclosure can create confusion even if the disclosures or references are entirely accurate. To avoid confusion, a reference to an affiliation (e.g., registered representative) shall not be placed in proximity to the wrong entity.

(H) Any reference to membership (e.g., Nasdaq, NASD, SIPC, etc.) shall be clearly identified as belonging to the entity that is the actual member of the organization.

### **(3) Specific Standards**

The foregoing standards set forth in subparagraphs (1) and (2) shall apply to all communications unless at least one of the following special circumstances exists, in which case the standards set forth herein would supersede the standards in subparagraphs (1) and (2).

(A) Doing Business As. A Nasdaq member may use a fictional name in communications provided that the following conditions are met:

(i) Non-Required Fictional Name. A member may voluntarily use a fictional name provided that the name has been filed with Nasdaq and the Commission, all business is conducted under that name and it is the only name by which the firm is recognized.

(ii) Required Fictional Name. If a state or other regulatory authority requires a member to use a fictional name, the following conditions shall be met:

a. The fictional name shall be used to conduct business only within the state or jurisdiction requiring its use.

b. If more than one state or jurisdiction requires a firm to use a fictional name, the same name shall be used in each, wherever possible.

c. Any communication shall disclose the name of the member and the fact that the firm is doing business in that state or jurisdiction under the fictional name, unless the regulatory authority prohibits such disclosure.

(B) Generic Names. A Nasdaq member may use an "umbrella" designation to promote name recognition, provided that the following conditions are met:

(i) The name of the member shall be clearly and prominently disclosed;

(ii) The relationship between the generic name and the

member shall be clear; and

(iii) There shall be no implication that the generic name is the name of a registered broker/dealer.

(C) Derivative Names. A Nasdaq member may use a derivative of the firm name to promote certain areas of the firm's business, provided that the name of the member is clearly and prominently disclosed. Absent such disclosure, the following conditions must be met:

(i) The name used to promote a specific area of the firm's business shall be a derivative of the member name; and

(ii) The derivative name shall not be misleading in the context in which it is being used.

(D) "Division of." A Nasdaq member firm may designate an aspect of its business as a division of the firm, provided that the following conditions are met:

(i) The designation shall only be used by a bona fide division of the member. This shall include:

a. a division resulting from a merger or acquisition that will continue the previous firm's business; or

b. a functional division that conducts or will conduct one specialized aspect of the firm's business.

(ii) The name of the member shall be clearly and prominently disclosed.

(iii) The division shall be clearly identified as a division of the member firm.

(E) "Service of/Securities Offered Through." A Nasdaq member firm may identify its brokerage service being offered through other institutions as a service of the member, provided that the following conditions are met:

(i) The name of the member shall be clearly and prominently disclosed.

(ii) The service shall be clearly identified as a service of the member firm.

(F) Telephone Directory Line Listings, Business Cards and

Letterhead. All such listings, cards or letterhead shall conform to the provisions of Rule 3010(g)(2).

Selected NASD Notices to Members: 98-83; 99-16.

**IM-2210-1. RESERVED**

**IM-2210-2. RESERVED**

**IM-2210-3. RESERVED**

**IM-2210-4. Limitations on Use of Nasdaq's Name**

**(a) Use of Nasdaq Name**

Members may indicate membership in Nasdaq in one or more of the following ways:

(1) A member may indicate membership in Nasdaq in recognized trade directories or other similar types of business listings.

(2) A member may indicate membership in Nasdaq in the member's advertisements and sales literature if such use is:

(A) separate from the regular text of the advertisement or sales literature;

(B) in a smaller type size and with less emphasis than that used for the member's name; and

(C) carries no direct or implied indication of Nasdaq approval of any security or service discussed in the advertisement or sales literature.

(3) A confirmation form for any Nasdaq transaction may include the following statement: "This transaction has been executed in conformity with the Nasdaq Uniform Practice Code."

(4) A member may indicate membership in Nasdaq on the door or entrance way of a member's principal office or a registered branch office in the following manner: "Member, Nasdaq" or "Member Nasdaq".

**(b) Certification of Membership**

Upon request to Nasdaq, a member shall be entitled to receive an appropriate certification of membership, which may be displayed in the principal office or a registered branch office of the member. The certification shall remain the property of

Nasdaq and shall be returned by the member upon request of the Nasdaq Board or the Chief Executive Officer of Nasdaq.

**(c) Fraudulent or Misleading Use Prohibited**

A member or person associated with a member shall not use Nasdaq's name in a fraudulent or misleading manner in connection with the promotion or sale of any security or in connection with any other aspect of the member's business or imply orally, visually, or in writing that Nasdaq endorses, indemnifies, or guarantees a member's business practices, selling methods, or class or type of securities offered.

**(d) Violation of Rule 2110**

An improper, fraudulent, or misleading use of Nasdaq's name by a member or person associated with a member shall be deemed conduct inconsistent with high standards of commercial honor and just and equitable principles of trade in violation of Rule 2110.

**2211. Telemarketing**

No member or person associated with a member shall:

(a) make outbound telephone calls to the residence of any person for the purpose of soliciting the purchase of securities or related services at any time other than between 8 a.m. and 9 p.m. local time at the called person's location, without the prior consent of the person; or

(b) make an outbound telephone call to any person for the purpose of soliciting the purchase of securities or related services without disclosing promptly and in a clear and conspicuous manner to the called person the following information:

(1) the identity of the caller and the member firm;

(2) the telephone number or address at which the caller may be contacted;  
and

(3) that the purpose of the call is to solicit the purchase of securities or related services.

(c) The prohibitions of paragraphs (a) and (b) shall not apply to telephone calls by any person associated with a member, or another associated person acting at the direction of such person for the purpose of maintaining and servicing the accounts of existing customers of the member under the control of or assigned to such associated person:

(1) to an existing customer who, within the preceding twelve months, has effected a securities transaction in, or made a deposit of funds or securities into,

an account that, at the time of the transaction or the deposit, was under the control of or assigned to, such associated person;

(2) to an existing customer who previously has effected a securities transaction in, or made a deposit of funds or securities into, an account that, at the time of the transaction or deposit, was under the control of or assigned to, such associated person, provided that such customer's account has earned interest or dividend income during the preceding twelve months, or

(3) to a broker or dealer.

(d) For the purposes of paragraph (c), the term "existing customer " means a customer for whom the broker or dealer, or a clearing broker or dealer on behalf of such broker or dealer, carries an account. The scope of this Rule is limited to the telemarketing calls described herein; the terms of this Rule shall not otherwise expressly or by implication impose on members any additional requirements with respect to the relationship between a member and a customer or between a person associated with a member and a customer.

## **2220. RESERVED**

## **2230. Confirmations**

A member at or before the completion of each transaction with a customer shall give or send to such customer written notification disclosing (a) whether such member is acting as a broker for such customer, as a dealer for his own account, as a broker for some other person, or as a broker for both such customer and some other person; and (b) in any case in which such member is acting as a broker for such customer or for both such customer and some other person, either the name of the person from whom the security was purchased or to whom it was sold for such customer and the date and time when such transaction took place or the fact that such information will be furnished upon the request of such customer, and the source and amount of any commission or other remuneration received or to be received by such member in connection with the transaction.

Selected NASD Notices to Members: 89-77, 90-11, 90-63.

## **IM-2230. Nasdaq InterMarket Confirmations**

Members who act as brokers for customers in transactions in listed securities in the Nasdaq InterMarket, and members who make markets in such securities, have sought clarification and uniformity regarding the disclosures to be made to customers in situations in which the Nasdaq InterMarket firms had confirmed to the retailing member plus or minus a differential, e.g., "20 plus 1/8" or "20 minus 1/8" for securities trading in fractions, or "\$20 plus \$.10" or "\$20 minus \$.10" for securities trading in decimals. In some such cases the confirmation from the retailing member to the customer has indicated that the transaction was effected for the customer at a price of 20 and that the

total commission paid by the customer was received by the retailing member, and it failed to disclose that the retailing member, in effect, absorbed the 1/8 or \$.10 differential charged by the Nasdaq InterMarket firm.

In cases such as those described above, where the retailing member effects an agency transaction for his customer with a Nasdaq InterMarket firm at a price which is in line with the then current price on the exchange plus or minus a differential, with the retailer absorbing the differential charged by the Nasdaq InterMarket firm, the following legend should be used by the retailing member to insure adequate disclosure on the confirmation to the customer:

We executed this transaction for you with a dealer who confirmed to us at the above price, plus (in the event you purchased) or less (in the event you sold) ....cents per share. This amount was absorbed by us out of the amount shown as our commission. Full details of this transaction are available upon request.

Failure to send an appropriate confirmation which conforms to the provisions hereof may involve not only conduct inconsistent with high standards of commercial honor and just and equitable principles of trade, but also violations of rules of the Commission, particularly the confirmation rule, SEC Rule 10b-10.

### **2231. Customer Confirmations - SmallCap Market Securities**

In addition to providing customers the information required by Rule 2230, members shall not effect transactions in Nasdaq SmallCap Market securities unless such member shall, at or before completion of such transaction, give or send to its customer written notification disclosing if the member is acting as principal for its own account:

- (a) (1) if it is not a market maker in that security, and if, after having received an order to buy from such customer, it purchased the security from another person to offset a contemporaneous sale to such customer, or after having received an order to sell from such customer it sold the security to another person to offset a contemporaneous purchase from such customer, the amount of any mark-up, mark-down or similar remuneration received in an equity security; or
- (2) in any other case of a transaction in a Nasdaq SmallCap Market equity security, the trade price reported in accordance with this Rule 4640 Series, the price to the customer in the transaction, and the difference, if any, between the reported trade price and the price to the customer, and
- (b) whether the member is a market maker in the security (otherwise than by reason of its acting as a block positioner in that security.) The terms used in this Rule shall have the same meaning as provided for in the Act and the rules adopted thereunder.

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Selected NASD Notices to Members: 92-39.

**2240. Disclosure of Control Relationship with Issuer**

A member controlled by, controlling, or under common control with, the issuer of any security, shall, before entering into any contract with or for a customer for the purchase or sale of such security, disclose to such customer the existence of such control, and if such disclosure is not made in writing, it shall be supplemented by the giving or sending of written disclosure at or before the completion of the transaction.

**2250. Disclosure of Participation or Interest in Primary or Secondary Distribution**

A member who is acting as a broker for a customer or for both such customer and some other person, or a member who is acting as a dealer and who receives or has promise of receiving a fee from a customer for advising such customer with respect to securities, shall, at or before the completion of any transaction for or with such customer in any security in the primary or secondary distribution of which such member is participating or is otherwise financially interested, give such customer written notification of the existence of such participation or interest.

**2260. Forwarding of Proxy and Other Materials**

(a) A member has an inherent duty in carrying out high standards of commercial honor and just and equitable principles of trade to forward (1) all proxy material which is properly furnished to it by the issuer of the securities or a stockholder of such issuer, to each beneficial owner of shares of that issue (or the beneficial owner's designated investment adviser) which are held by the member for the beneficial owner thereof and (2) all annual reports, information statements and other material sent to stockholders, which are properly furnished to it by the issuer of the securities to each beneficial owner of shares of that issue (or the beneficial owner's designated investment adviser) which are held by the member for the beneficial owner thereof.

(b) No member shall give a proxy to vote stock which is registered in its name, except as required or permitted under the provisions of paragraphs (c) or (d) hereof, unless such member is the beneficial owner of such stock.

(c) (1) Whenever an issuer or stockholder of such issuer soliciting proxies shall timely furnish to a member:

(A) sufficient copies of all soliciting material which such person is sending to registered holders, and

(B) satisfactory assurance that he will reimburse such member for all out-of-pocket expenses, including reasonable clerical expenses incurred by such member in connection with such solicitation,

such member shall transmit promptly to each beneficial owner of stock of such issuer (or the beneficial owner's designated investment adviser)

which is in its possession or control and registered in a name other than the name of the beneficial owner, all such material furnished. Such material shall include a signed proxy indicating the number of shares held for such beneficial owner and bearing a symbol identifying the proxy with proxy records maintained by the member, and a letter informing the beneficial owner (or the beneficial owner's designated investment adviser) of the time limit and necessity for completing the proxy form and forwarding it to the person soliciting proxies prior to the expiration of the time limit in order for the shares to be represented at the meeting. A member shall furnish a copy of the symbols to the person soliciting the proxies and shall also retain a copy thereof pursuant to the provisions of SEC Rule 17a-4.

(2) Notwithstanding the provisions of subparagraph (1), a member may give a proxy to vote any stock pursuant to the rules of any national securities exchange to which the member is also responsible provided that the records of the member clearly indicate which procedure it is following.

(3) This paragraph shall not apply to beneficial owners residing outside of the United States of America, although members may voluntarily comply with the provisions hereof in respect to such persons if they so desire.

(d) (1) A member may give a proxy to vote any stock registered in its name if such member holds such stock as executor, administrator, guardian, trustee, or in a similar representative or fiduciary capacity with authority to vote.

(2) A member which has in its possession or within its control stock registered in the name of another member and which desires to transmit signed proxies pursuant to the provisions of paragraph (c), shall obtain the requisite number of signed proxies from such holder of record.

(3) Notwithstanding the foregoing,

(A) any member designated by a named ERISA<sup>ii</sup>\* Plan fiduciary as the investment manager of stock held as assets of the ERISA Plan may vote the proxies in accordance with the ERISA Plan fiduciary responsibilities if the ERISA Plan expressly grants discretion to the investment manager to manage, acquire, or dispose of any plan asset and has not expressly reserved the proxy voting right for the named ERISA Plan fiduciary; and

(B) any person registered as an investment adviser under the Investment Advisers Act of 1940 who exercises investment discretion pursuant to an advisory contract for the beneficial owner and has been designated in writing by the beneficial owner to vote the proxies for stock which is in the possession or control of the member, may vote such

proxies.

(e) (1) A member when so requested by an issuer and upon being furnished with:

(A) sufficient copies of annual reports, information statements or other material sent to stockholders, and

(B) satisfactory assurance that it will be reimbursed by such issuer for all out-of-pocket expenses, including reasonable clerical expenses,

shall transmit promptly to each beneficial owner of stock of such issuer (or the beneficial owner's designated investment adviser) which is in its possession and control and registered in a name other than the name of the beneficial owner of all such material furnished.

(2) This paragraph shall not apply to beneficial owners residing outside of the United States of America although members may voluntarily comply with the provisions hereof in respect to such persons if they so desire.

(f) For purposes of this Rule, the term "designated investment adviser" is a person registered under the Investment Advisers Act of 1940 who exercises investment discretion pursuant to an advisory contract for the beneficial owner and is designated in writing by the beneficial owner to receive proxy and related materials and vote the proxy, and to receive annual reports and other material sent to stock holders.

(1) The written designation must be signed by the beneficial owner; be addressed to the member; and include the name of the designated investment adviser.

(2) Members who receive such a written designation from a beneficial owner must ensure that the designated investment adviser is registered with the Commission pursuant to the Investment Advisers Act of 1940 and that the investment adviser is exercising investment discretion over the customer's account pursuant to an advisory contract to vote proxies and/or to receive proxy soliciting material, annual reports and other material. Members must keep records substantiating this information.

(3) Beneficial owners have an unqualified right at any time to rescind designation of the investment adviser to receive materials and to vote proxies. The rescission must be in writing and submitted to the member.

Selected NASD Notices to Members: 85-26, 86-35, 86-46, 91-57, 92-17, 95-45.

**IM-2260. Suggested Rates of Reimbursement**

(a) The following suggested rates of reimbursement for expenses incurred in forwarding proxy material, annual reports, information statements and other material are to be used as a guide by members:

**(1) Charges for Initial Proxy and/or Annual Report Mailings**

(A) 60 cents for each set of proxy material, i.e., proxy statement, form of proxy and annual report when mailed as a unit, plus postage, with a minimum of \$5.00 for all sets mailed;

(B) 20 cents for each copy, plus postage, for annual reports, which are mailed separately from the proxy material pursuant to the instruction of the person soliciting proxies.

**(2) Charges for Proxy Follow-Up Mailings**

(A) 40 cents for each set of follow-up material, plus postage, when the follow-up material is mailed to all beneficial owners;

(B) 60 cents for each set of follow-up material, plus postage, when the follow-up material is mailed only to beneficial owners who have not responded to the initial mailing.

**(3) Reserved****(4) Additional Fee for Proxy Solicitation**

Six and one-half cents per shareholder name provided to the issuer pursuant to the issuer's request.

**(5) Charges for Interim Report, Post Meeting Report and Other Material Mailings**

30 cents for each copy, plus postage, for interim reports, post meeting reports, or other material with a minimum of \$2.00 for all sets mailed.

(b) Members may charge for envelopes, provided that they are not furnished by the person soliciting proxies.

(c) Members are reminded that any such charges must be reasonable. Accordingly, this is a guide and a member may request reimbursement of expenses at other rates after taking into consideration all relevant factors.

**2270. Disclosure of Financial Condition to Customers**

(a) A member shall make available to inspection by any bona fide regular customer, upon request, the information relative to such member's financial condition as disclosed in its most recent balance sheet prepared either in accordance with such member's usual practice or as required by any state or federal securities laws, or any rule or regulation thereunder.

(b) As used in paragraph (a) of this Rule, the term "customer" means any person who, in the regular course of such member's business, has cash or securities in the possession of such member.

**2300. TRANSACTIONS WITH CUSTOMERS****2310. Recommendations to Customers (Suitability)**

(a) In recommending to a customer the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his or her other security holdings and as to his or her financial situation and needs.

(b) Prior to the execution of a transaction recommended to a non-institutional customer, other than transactions with customers where investments are limited to money market mutual funds, a member shall make reasonable efforts to obtain information concerning:

- (1) the customer's financial status;
- (2) the customer's tax status;
- (3) the customer's investment objectives; and
- (4) such other information used or considered to be reasonable by such member or registered representative in making recommendations to the customer.

(c) For purposes of this Rule, the term "non-institutional customer" shall mean a customer that does not qualify as an "institutional account" under Rule 3110(c)(4).

**IM-2310-1. [Reserved]****IM-2310-2. Fair Dealing with Customers**

(a) (1) Implicit in all member and registered representative relationships with customers and others is the fundamental responsibility for fair dealing. Sales efforts must therefore be undertaken only on a basis that can be judged as being within the ethical standards of Nasdaq's Rules, with particular emphasis on the requirement to deal fairly with the public.

- (2) This does not mean that legitimate sales efforts in the securities

business are to be discouraged by requirements which do not take into account the variety of circumstances which can enter into the member-customer relationship. It does mean, however, that sales efforts must be judged on the basis of whether they can be reasonably said to represent fair treatment for the persons to whom the sales efforts are directed, rather than on the argument that they result in profits to customers.

(b) The Rules have been interpreted, disciplinary action has been taken, and penalties have been imposed in many situations where broker-dealers' sales efforts have exceeded the reasonable grounds of fair dealing. Some practices that have resulted in disciplinary action and that clearly violate this responsibility for fair dealing are set forth below, as a guide to members:

**(1) Recommending Speculative Low-Priced Securities**

Recommending speculative low-priced securities to customers without knowledge of or attempt to obtain information concerning the customers' other securities holdings, their financial situation and other necessary data. The principle here is that this practice, by its very nature, involves a high probability that the recommendation will not be suitable for at least some of the persons solicited. This has particular application to high pressure telephone sales campaigns.

**(2) Excessive Trading Activity**

Excessive activity in a customer's account, often referred to as "churning" or "overtrading." There are no specific standards to measure excessiveness of activity in customer accounts because this must be related to the objectives and financial situation of the customer involved.

**(3) Trading in Mutual Fund Shares**

Trading in mutual fund shares, particularly on a short-term basis. It is clear that normally these securities are not proper trading vehicles and such activity on its face may raise the question of Rule violation.

**(4) Fraudulent Activity**

(A) Numerous instances of fraudulent conduct have been acted upon and have resulted in penalties against broker-dealers. Among some of these activities are:

**(i) Fictitious Accounts**

Establishment of fictitious accounts in order to execute transactions which otherwise would be prohibited, such as the

purchase of hot issues, or to disguise transactions which are against firm policy.

**(ii) Discretionary Accounts**

Transactions in discretionary accounts in excess of or without actual authority from customers.

**(iii) Unauthorized Transactions**

Causing the execution of transactions which are unauthorized by customers or the sending of confirmations in order to cause customers to accept transactions not actually agreed upon.

**(iv) Misuse of Customers' Funds or Securities**

Unauthorized use or borrowing of customers' funds or securities.

(B) In addition, other fraudulent activities, such as forgery, non-disclosure or misstatement of material facts, manipulations and various deceptions, have been found to be Rule violations. These same activities are also subject to the civil and criminal laws and sanctions of federal and state governments.

**(5) Recommending Purchases Beyond Customer Capability**

Recommending the purchase of securities or the continuing purchase of securities in amounts which are inconsistent with the reasonable expectation that the customer has the financial ability to meet such a commitment.

(c) While most members are fully aware of the fairness required in dealing with customers, it is anticipated that the practices enumerated in paragraph (b), which are not all inclusive, will be of future assistance in the training and education of new personnel.

(d) The Commission has also recognized that brokers and dealers have an obligation of fair dealing in actions under the general anti-fraud provisions of the federal securities laws. The Commission bases this obligation on the principle that when a securities dealer opens his or her business he or she is, in effect, representing that he or she will deal fairly with the public. Certain of the Commission's cases on fair dealing involve practices not covered in the foregoing illustrations. Usually, any breach of the obligation of fair dealing as determined by the Commission under the anti-fraud provisions of the securities laws could be considered a violation of Nasdaq's Rules.

**(e) Fair Dealing with Customers with Regard to Derivative Products or New Financial Products**

Members' obligations for fair dealing with customers when making recommendations or accepting orders for new financial products are emphasized. As new products are introduced from time to time, it is important that members make every effort to familiarize themselves with each customer's financial situation, trading experience, and ability to meet the risks involved with such products and to make every effort to make customers aware of the pertinent information regarding the products. Members must follow specific guidelines, set forth below, for qualifying the accounts to trade the products and for supervising the accounts thereafter.

**(1) Index Warrants**

Members are obliged to comply with the Rules, regulations and procedures applicable to index warrants and foreign currency warrants contained in the Rule 2840 Series.

**(2) Hybrid Securities and Selected Equity-Linked Debt Securities ("SEEDS") Designated as Nasdaq National Market Securities Pursuant to the Rule 4400 Series**

Members are obligated to comply with any Rules, regulations, or procedures applicable to such securities pursuant to the Rule 4420 Series, as well as any other applicable Nasdaq Rule, regulation, or procedure.

Selected NASD Notices to Members: 85-26, 86-35, 86-46, 91-57, 92-17, 95-45.

**Selected SEC Decision**

Curtis I. Wilson, SEC Rel. No. 34-26425 (1989).

**IM-2310-3. Suitability Obligations to Institutional Customers**

**Preliminary Statement as to Members' Obligations**

Nasdaq believes it is appropriate to provide further guidance to members on their suitability obligations when making recommendations to institutional customers regarding equity securities.

Nasdaq's suitability rule is fundamental to fair dealing and is intended to promote ethical sales practices and high standards of professional conduct. Members' responsibilities include having a reasonable basis for recommending a particular security or strategy, as well as having reasonable grounds for believing the recommendation is suitable for the customer to whom it is made. Members are expected to meet the same high standards of competence, professionalism, and good faith regardless of the financial circumstances of the customer.

Rule 2310(a) requires that,

In recommending to a customer the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his or her other security holdings and as to his or her financial situation and needs.

This interpretation concerns only the manner in which a member determines that a recommendation is suitable for a particular institutional customer. The manner in which a member fulfills this suitability obligation will vary depending on the nature of the customer and the specific transaction. Accordingly, this interpretation deals only with guidance regarding how a member may fulfill such "customer-specific suitability obligations" under Rule 2310(a).<sup>iii</sup>

While it is difficult to define in advance the scope of a member's suitability obligation with respect to a specific institutional customer transaction recommended by a member, certain factors have been identified which may be relevant when considering compliance with Rule 2310(a). These factors are not intended to be requirements or the only factors to be considered but are offered merely as guidance in determining the scope of a member's suitability obligations.

### **Considerations Regarding the Scope of Members' Obligations to Institutional Customers**

The two most important considerations in determining the scope of a member's suitability obligations in making recommendations to an institutional customer are the customer's capability to evaluate investment risk independently and the extent to which the customer is exercising independent judgment in evaluating a member's recommendation. A member must determine, based on the information available to it, the customer's capability to evaluate investment risk. In some cases, the member may conclude that the customer is not capable of making independent investment decisions in general. In other cases, the institutional customer may have general capability, but may not be able to understand a particular type of instrument or its risk. This is more likely to arise with relatively new types of instruments, or those with significantly different risk or volatility characteristics than other investments generally made by the institution. If a customer is either generally not capable of evaluating investment risk or lacks sufficient capability to evaluate the particular product, the scope of a member's customer-specific obligations under the suitability rule would not be diminished by the fact that the member was dealing with an institutional customer. On the other hand, the fact that a customer initially needed help understanding a potential investment need not necessarily imply that the customer did not ultimately develop an understanding and make an independent investment decision.

A member may conclude that a customer is exercising independent judgment if the customer's investment decision will be based on its own independent assessment of the opportunities and risks presented by a potential investment, market factors and other investment considerations. Where the broker-dealer has reasonable grounds for concluding that the institutional customer is making independent investment decisions and is capable of independently evaluating investment risk, then a member's obligation to determine that a recommendation is suitable for a particular customer is fulfilled. Where a customer has delegated decision-making authority to an agent, such as an investment advisor or a bank trust department, this interpretation shall be applied to the agent.

A determination of capability to evaluate investment risk independently will depend on an examination of the customer's capability to make its own investment decisions, including the resources available to the customer to make informed decisions. Relevant considerations could include:

- the use of one or more consultants, investment advisers or bank trust departments;
- the general level of experience of the institutional customer in financial markets and specific experience with the type of instruments under consideration;
- the customer's ability to understand the economic features of the security involved;
- the customer's ability to independently evaluate how market developments would affect the security; and
  - the complexity of the security or securities involved.

A determination that a customer is making independent investment decisions will depend on the nature of the relationship that exists between the member and the customer. Relevant considerations could include:

- any written or oral understanding that exists between the member and the customer regarding the nature of the relationship between the member and the customer and the services to be rendered by the member;
- the presence or absence of a pattern of acceptance of the member's recommendations;
- the use by the customer of ideas, suggestions, market views and information obtained from other members or market professionals, particularly those relating to the same type of securities; and
- the extent to which the member has received from the customer current comprehensive portfolio information in connection with discussing recommended transactions or has not been provided important information regarding its portfolio or investment objectives.

Members are reminded that these factors are merely guidelines which will be utilized to determine whether a member has fulfilled its suitability obligations with respect to a specific institutional customer transaction and that the inclusion or absence of any of these factors is not dispositive of the determination of suitability. Such a determination can only be made on a case-by-case basis taking into consideration all the facts and circumstances of a particular member/customer relationship, assessed in the context of a particular transaction.

For purposes of this interpretation, an institutional customer shall be any entity other than a natural person. In determining the applicability of this interpretation to an institutional customer, Nasdaq will consider the dollar value of the securities that the institutional customer has in its portfolio and/or under management. While this interpretation is potentially applicable to any institutional customer, the guidance contained herein is more appropriately applied to an institutional customer with at least \$10 million invested in securities in the aggregate in its portfolio and/or under management.

### **2320. Best Execution and Interpositioning**

(a) In any transaction for or with a customer, a member and persons associated with a member shall use reasonable diligence to ascertain the best inter-dealer market for the subject security and buy or sell in such market so that the resultant price to the customer is as favorable as possible under prevailing market conditions. Among the factors that will be considered in determining whether a member has used "reasonable diligence" are:

- (1) The character of the market for the security, e.g., price, volatility, relative liquidity, and pressure on available communications;
- (2) the size and type of transaction;
- (3) the number of primary markets checked;
- (4) location and accessibility to the customer's broker/dealer of primary markets and quotations sources.

(b) In any transaction for or with a customer, no member or person associated with a member shall interject a third party between the member and the best available market except in cases where the member can demonstrate that to his or her knowledge at the time of the transaction the total cost or proceeds of the transaction, as confirmed to the member acting for or with the customer, was better than the prevailing inter-dealer market for the security. A member's obligations to his or her customer are generally not fulfilled when he or she channels transactions through another broker/dealer or some person in a similar position, unless he or she can show that by so doing he or she reduced the costs of the transactions to the customer.

(c) When a member cannot execute directly with a market maker but must employ a broker's broker or some other means in order to insure an execution advantageous to the customer, the burden of showing the acceptable circumstances for doing so is on the retail firm. Examples of acceptable circumstances are where a customer's order is "crossed" with another retail firm which has a corresponding order on the other side, or where the identity of the retail firm, if known, would likely cause undue price movements adversely affecting the cost or proceeds to the customer.

(d) Failure to maintain or adequately staff an order room or other department assigned to execute customers' orders cannot be considered justification for executing away from the best available market; nor can channeling orders through a third party as described above as reciprocation for service or business operate to relieve a member of his or her obligations. However, the channeling of customers' orders through a broker's broker or third party pursuant to established correspondent relationships under which executions are confirmed directly to the member acting as agent for the customer, such as where the third party gives up the name of the retail firm, are not prohibited if the cost of such service is not borne by the customer.

(e) A member through whom a retail order is channeled, as described above, and who knowingly is a party to an arrangement whereby the initiating member has not fulfilled his or her obligations under this Rule, will also be deemed to have violated this Rule.

(f) The obligations described in paragraphs (a) through (e) above exist not only where the member acts as agent for the account of his or her customer but also where retail transactions are executed as principal and contemporaneously offset. Such obligations do not relate to the reasonableness of commission rates, markups or markdowns which are governed by Rule 2440 and IM-2440.

### **2330. Customers' Securities or Funds**

#### **(a) Improper Use**

No member or person associated with a member shall make improper use of a customer's securities or funds.

#### **(b) General Provisions**

Every member in the conduct of its business shall adhere to the provisions of SEC Rule 15c3-3 with respect to obtaining possession and control of securities, and the maintenance of appropriate cash reserves. For the purposes of this Rule, the definitions contained in Rule 15c3-3 shall apply.

#### **(c) Authorization to Lend**

No member shall lend, either to himself or to others, securities carried for the account of any customer, which are eligible to be pledged or loaned unless such member shall first have obtained from the customer a written authorization permitting the lending of securities thus carried by such member.

**(d) Segregation and Identification of Securities**

No member shall hold securities carried for the account of any customer which have been fully paid for or which are excess margin securities unless such securities are segregated and identified by a method which clearly indicates the interest of such customer in those securities.

*Cross Reference - "Hypothecation of Customers' Securities"  
See SEC Rules and Regulation T Tab*

**(e) Prohibition Against Guarantees**

No member or person associated with a member shall guarantee a customer against loss in any securities account of such customer carried by the member or in any securities transaction effected by the member with or for such customer.

**(f) Sharing in Accounts; Extent Permissible**

(1) (A) Except as provided in paragraph (f)(2) no member or person associated with a member shall share directly or indirectly in the profits or losses in any account of a customer carried by the member or any other member; provided, however, that a member or person associated with a member may share in the profits or losses in such an account if (i) such member or person associated with a member obtains prior written authorization from the member carrying the account; and (ii) the member or person associated with a member shall share in the profits or losses in any account of such customer only in direct proportion to the financial contributions made to such account by either the member or person associated with a member.

(B) Exempt from the direct proportionate share limitation of paragraph (f)(1)(A)(ii) are accounts of the immediate family of such member or person associated with a member. For purposes of this Rule, the term "immediate family" shall include parents, mother-in-law or father-in-law, husband or wife, children or any relative to whose support the member or person associated with a member otherwise contributes directly or indirectly.

(2) Notwithstanding the prohibition of paragraph (f)(1), a member or person associated with a member may receive compensation based on a share in profits or gains in an account if all of the following conditions are satisfied:<sup>iv\*</sup>

(A) The member or person associated with a member seeking such compensation obtains prior written authorization from the member carrying the account;

(B) The customer has at the time the account is opened either a net worth which the member or person associated with a member reasonably believes to be not less than \$1,000,000, or the minimum amount invested in the account is not less than \$500,000;

(C) The member or person associated with a member reasonably believes the customer is able to understand the proposed method of compensation and its risks prior to entering into the arrangement;

(D) The compensation arrangement is set forth in a written agreement executed by the customer and the member;

(E) The member or person associated with a member reasonably believes, immediately prior to entering into the arrangement, that the agreement represents an arm's-length arrangement between the parties;

(F) The compensation formula takes into account both gains and losses realized or accrued in the account over a period of at least one year; and

(G) The member has disclosed to the customer all material information relating to the arrangement including the method of compensation and potential conflicts of interest which may result from the compensation formula.

Selected NASD Notices to Members: 83-74, 86-74, 88-55, 94-93.

**Selected SEC Decisions:**

Walter C. Nathan, SEC Rel. No. 34-24569 (1987).

Curtis I. Wilson, SEC Rel. No. 34-26425 (1989).

**IM-2330. Segregation of Customers' Securities**

(a) Rule 2330(d) requires members to segregate and identify by customers both fully paid and "excess margin" securities. With regard to a customer's account which contains only stocks, it is general practice for firms to segregate that portion of the stocks having a market value in excess of 140% of the debit balance therein. When a customer's account contains bonds, the basis upon which the member is borrowing or can borrow on such bonds should be taken into consideration in determining the amount of securities to be segregated.

(b) Following are three general types of segregation of customers' securities

currently in use by many firms:

- (1) Physical segregation of securities by issue, with a separate list showing ownership of the securities by each customer. The listing, on cards or other records, should reflect all changes in ownership interest. This method is for securities in street name (not in individual customers' names), but the proportionate interests of the individual customers are indicated by the records.
  - (2) Physical segregation of securities by issue, affixing to each certificate a tab or other identification showing the name of the beneficial owner of the certificate. This may be used for shares in street name or in the customer's name.
  - (3) Specific segregation of all certificates of each customer in separate envelopes or folders, identified by customer, or by clipping the certificates together and identifying the customer by tab or other notation affixed to the segregated certificates.
- (c) In the methods enumerated in paragraph (b), the records should note the dates when the securities are segregated. When such securities are not in the actual custody of the member, for instance, when they are in the physical possession of a correspondent firm, their location and the means by which they may be identified as belonging to each customer should be indicated on the books of the member carrying the customers' accounts.

#### **2340. Customer Account Statements**

(a) Each general securities member shall, with a frequency of not less than once every calendar quarter, send a statement of account containing a description of any securities positions, money balances, or account activity to each customer whose account had a security position, money balance, or account activity during the period since the last such statement was sent to the customer.

(b) For purposes of this Rule, the term "account activity" shall include, but not be limited to, purchases, sales, interest credits or debits, charges or credits, dividend payments, transfer activity, securities receipts or deliveries, and/or journal entries relating to securities or funds in the possession or control of the member.

(c) For purposes of this Rule, the term "general securities member" shall refer to any member which conducts a general securities business and is required to calculate its net capital pursuant to the provisions of SEC Rule 15c3-1(a), except for paragraphs (a)(2) and (a)(3). Notwithstanding the foregoing definition, a member which does not carry customer accounts and does not hold customer funds and securities is exempt from the provisions of this Rule.

(d) Pursuant to the Rule 9600 Series, Nasdaq may exempt any member from the provisions of this Rule for good cause shown.

Selected NASD Notices to Members: 92-60, 93-50, 94-96.

## **2350. RESERVED**

### **2360. Approval Procedures for Day-Trading Accounts**

(a) No member that is promoting a day-trading strategy, directly or indirectly, shall open an account for or on behalf of a non-institutional customer, unless, prior to opening the account, the member has furnished to the customer the risk disclosure statement set forth in Rule 2361 and has:

- (1) approved the customer's account for a day-trading strategy in accordance with the procedures set forth in paragraph (b) and prepared a record setting forth the basis on which the member has approved the customer's account; or
- (2) received from the customer a written agreement that the customer does not intend to use the account for the purpose of engaging in a day-trading strategy, except that the member may not rely on such agreement if the member knows that the customer intends to use the account for the purpose of engaging in a day-trading strategy.

(b) In order to approve a customer's account for a day-trading strategy, a member shall have reasonable grounds for believing that the day-trading strategy is appropriate for the customer. In making this determination, the member shall exercise reasonable diligence to ascertain the essential facts relative to the customer, including:

- (1) Investment objectives;
- (2) Investment and trading experience and knowledge (e.g., number of years, size, frequency and type of transactions);
- (3) Financial situation, including: estimated annual income from all sources, estimated net worth (exclusive of family residence), and estimated liquid net worth (cash, securities, other);
- (4) Tax status;
- (5) Employment status (name of employer, self-employed or retired);
- (6) Marital status; number of dependents; and
- (7) Age.

(c) If a member that is promoting a day-trading strategy opens an account for a non-institutional customer in reliance on a written agreement from the customer pursuant to paragraph (a)(2) and, following the opening of the account, knows that the customer is using the account for a day-trading strategy, then the member shall be required to approve the customer's account for a day-trading strategy in accordance with paragraph (a)(1) as soon as practicable, but in no event later than 10 days following the date that such member knows that the customer is using the account for such a strategy.

(d) Any record or written statement prepared or obtained by a member pursuant to this rule shall be preserved in accordance with Rule 3110(a).

(e) For purposes of this rule, the term "day-trading strategy" means an overall trading strategy characterized by the regular transmission by a customer of intra-day orders to effect both purchase and sale transactions in the same security or securities.

(f) For purposes of this rule, the term "non-institutional customer" means a customer that does not qualify as an "institutional account" under Rule 3110(c)(4).

(g) A firm will not be deemed to be "promoting a day-trading strategy" for purposes of this rule solely by its engaging in the following activities:

- (1) Promoting efficient execution services or lower execution costs based on multiple trades;
- (2) Providing general investment research or advertising the high quality or prompt availability of such general research; and
- (3) Having a Web site that provides general financial information or news or that allows the multiple entry of intra-day purchases and sales of the same securities.

### **2361. Day-Trading Risk Disclosure Statement**

(a) Except as provided in paragraph (b), no member that is promoting a day-trading strategy, directly or indirectly, shall open an account for or on behalf of a non-institutional customer unless, prior to opening the account, the member has furnished to each customer, individually, in writing or electronically, the following disclosure statement:

You should consider the following points before engaging in a day-trading strategy. For purposes of this notice, a "day-trading strategy" means an overall trading strategy characterized by the regular transmission by a customer of intra-day orders to effect both purchase and sale transactions in the same security or securities.

**Day trading can be extremely risky.** Day trading generally is not appropriate for someone of limited resources and limited investment or trading experience and low risk tolerance. You should be prepared to lose all of the funds that you use for day trading. In particular, you should not fund day-trading activities with retirement savings, student loans, second mortgages, emergency funds, funds set aside for purposes such as education or home ownership, or funds required to meet your living expenses. Further, certain evidence indicates that an investment of less than \$50,000 will significantly impair the ability of a day trader to make a profit. Of course, an investment of \$50,000 or more will in no way guarantee success.

**Be cautious of claims of large profits from day trading.** You should be wary of advertisements or other statements that emphasize the potential for large profits in day trading. Day trading can also lead to large and immediate financial losses.

**Day trading requires knowledge of securities markets.** Day trading requires in-depth knowledge of the securities markets and trading techniques and strategies. In attempting to profit through day trading, you must compete with professional, licensed traders employed by securities firms. You should have appropriate experience before engaging in day trading.

**Day trading requires knowledge of a firm's operations.** You should be familiar with a securities firm's business practices, including the operation of the firm's order execution systems and procedures. Under certain market conditions, you may find it difficult or impossible to liquidate a position quickly at a reasonable price. This can occur, for example, when the market for a stock suddenly drops, or if trading is halted due to recent news events or unusual trading activity. The more volatile a stock is, the greater the likelihood that problems may be encountered in executing a transaction. In addition to normal market risks, you may experience losses due to system failures.

**Day trading will generate substantial commissions, even if the per trade cost is low.** Day trading involves aggressive trading, and generally you will pay commissions on each trade. The total daily commissions that you pay on your trades will add to your losses or significantly reduce your earnings. For instance, assuming that a trade cost \$16 and an average of 29 transactions are conducted per day, an investor would need to generate an annual profit of \$111,360 just to cover commission expenses.

**Day trading on margin or short selling may result in losses beyond your initial investment.** When you day trade with funds borrowed from a firm or someone else, you can lose more than the funds you originally placed at risk. A decline in the value of the securities that are purchased may require you to

provide additional funds to the firm to avoid the forced sale of those securities or other securities in your account. Short selling as part of your day-trading strategy also may lead to extraordinary losses, because you may have to purchase a stock at a very high price in order to cover a short position.

**Potential Registration Requirements.** Persons providing investment advice for others or managing the securities accounts for others may need to register as either an “Investment Advisor” under the Investment Advisors Act of 1940 or as a “Broker” or “Dealer” under the Securities Exchange Act of 1934. Such activities may also trigger state registration requirements.

(b) In lieu of providing the disclosure statement specified in paragraph (a), a member that is promoting a day-trading strategy may provide to the customer, individually, in writing or electronically, prior to opening the account, an alternative disclosure statement, provided that:

(1) The alternative disclosure statement shall be substantially similar to the disclosure statement specified in paragraph (a); and

(2) The alternative disclosure statement shall be approved by signature or initial, prior to use, by a registered principal of the member.

(c) For purposes of this rule, the term “day-trading strategy” shall have the meaning provided in Rule 2360(e).

(d) For purposes of this Rule, the term “non-institutional customer” means a customer that does not qualify as an “institutional account” under Rule 3110(c)(4).

## **2400. COMMISSIONS, MARK-UPS AND CHARGES**

### **2410. RESERVED**

### **2420. RESERVED**

### **2430. RESERVED**

### **2440. Fair Prices and Commissions**

In transactions with customers, if a member buys for its own account from its customer, or sells for its own account to its customer, it shall buy or sell at a price which is fair, taking into consideration all relevant circumstances, including market conditions with respect to such security at the time of the transaction, the expense involved, and the fact that the member is entitled to a profit; and if the member acts as agent for its customer in any such transaction, it shall not charge its customer more than a fair commission or service charge, taking into consideration all relevant circumstances, including market conditions with respect to such security at the time of the transaction,

the expense of executing the order and the value of any service the member may have rendered by reason of its experience in and knowledge of such security and the market therefor.

### **IM-2440. Mark-Up Policy**

The question of fair mark-ups or spreads is one for which no definitive answer can be given and no interpretation can be all-inclusive. The obvious reason for this difficulty is that a mark-up that might be considered fair in one transaction could be unfair in another transaction because of different circumstances. In 1943, the NASD adopted what has become known as the "5% Policy" to be applied to transactions executed for customers. It was based upon studies demonstrating that the large majority of customer transactions were effected at a mark-up of 5% or less. The Policy was reviewed by the NASD on numerous occasions and each time the NASD has reaffirmed the philosophy expressed in 1943. Nasdaq affirms the 5% Policy and has adopted the following interpretation under Rule 2440.

It shall be deemed a violation of Rule 2110 and Rule 2440 for a member to enter into any transaction with a customer in any security at any price not reasonably related to the current market price of the security or to charge a commission which is not reasonable.

#### **(a) General Considerations**

- (1) The "5% Policy" is a guide, not a rule.
- (2) A member may not justify mark-ups on the basis of expenses which are excessive.
- (3) The mark-up over the prevailing market price is the significant spread from the point of view of fairness of dealings with customers in principal transactions. In the absence of other bona fide evidence of the prevailing market, a member's own contemporaneous cost is the best indication of the prevailing market price of a security.
- (4) A mark-up pattern of 5% or even less may be considered unfair or unreasonable under the "5% Policy."
- (5) Determination of the fairness of mark-ups must be based on a consideration of all the relevant factors, of which the percentage of mark-up is only one.

#### **(b) Relevant Factors**

Some of the factors that members should take into consideration in determining the fairness of a mark-up are as follows:

**(1) The Type of Security Involved**

Some securities customarily carry a higher mark-up than others. For example, a higher percentage of mark-up customarily applies to a common stock transaction than to a bond transaction of the same size. Likewise, a higher percentage applies to sales of units of direct participation programs and condominium securities than to sales of common stock.

**(2) The Availability of the Security in the Market**

In the case of an inactive security the effort and cost of buying or selling the security, or any other unusual circumstances connected with its acquisition or sale, may have a bearing on the amount of mark-up justified.

**(3) The Price of the Security**

While there is no direct correlation, the percentage of mark-up or rate of commission generally increases as the price of the security decreases. Even where the amount of money is substantial, transactions in lower priced securities may require more handling and expense and may warrant a wider spread.

**(4) The Amount of Money Involved in a Transaction**

A transaction which involves a small amount of money may warrant a higher percentage of mark-up to cover the expenses of handling.

**(5) Disclosure**

Any disclosure to the customer, before the transaction is effected, of information which would indicate (A) the amount of commission charged in an agency transaction or (B) mark-up made in a principal transaction is a factor to be considered. Disclosure itself, however, does not justify a commission or mark-up which is unfair or excessive in light of all other relevant circumstances.

**(6) The Pattern of Mark-Ups**

While each transaction must meet the test of fairness, particular attention should be given to the pattern of a member's mark-ups.

**(7) The Nature of the Member's Business**

There are differences in the services and facilities which are needed by, and provided for, customers of members. If not excessive, the cost of providing such services and facilities, particularly when they are of a continuing nature, may properly be considered in determining the fairness of a member's mark-ups.

**(c) Transactions to Which the Policy is Applicable**

The Policy applies to all securities traded on Nasdaq, in the following types of transactions:

(1) A transaction in which a member buys a security to fill an order for the same security previously received from a customer. This transaction would include the so-called "riskless" or "simultaneous" transaction.

(2) A transaction in which the member sells a security to a customer from inventory. In such a case the amount of the mark-up would be determined on the basis of the mark-up over the bona fide representative current market. The amount of profit or loss to the member from market appreciation or depreciation before, or after, the date of the transaction with the customer would not ordinarily enter into the determination of the amount or fairness of the mark-up.

(3) A transaction in which a member purchases a security from a customer. The price paid to the customer or the mark-down applied by the member must be reasonably related to the prevailing market price of the security.

(4) A transaction in which the member acts as agent. In such a case, the commission charged the customer must be fair in light of all relevant circumstances.

(5) Transactions wherein a customer sells securities to, or through, a broker/dealer, the proceeds from which are utilized to pay for other securities purchased from, or through, the broker/dealer at or about the same time. In such instances, the mark-up shall be computed in the same way as if the customer had purchased for cash and in computing the mark-up there shall be included any profit or commission realized by the dealer on the securities being liquidated, the proceeds of which are used to pay for securities being purchased.

**(d) Transactions to Which the Policy is Not Applicable**

The Mark-Up Policy is not applicable to the sale of securities where a prospectus or offering circular is required to be delivered and the securities are sold at the specific public offering price.

**2450. RESERVED**

**2460. Payments for Market Making**

(a) No member or person associated with a member shall accept any payment or other consideration, directly or indirectly, from an issuer of a security, or any affiliate or promoter thereof, for publishing a quotation, acting as market maker in a security, or submitting an application in connection therewith.

(b) The provisions of paragraph (a) shall not preclude a member from accepting:

(1) payment for bona fide services, including, but not limited to, investment banking services (including underwriting compensation and fees); and

(2) reimbursement of any payment for registration imposed by the Securities and Exchange Commission or state regulatory authorities and for listing of an issue of securities imposed by a self-regulatory organization.

(c) For purposes of this rule, the following terms shall have the stated meanings:

(1) "affiliate" shall mean a company that controls, is controlled by, or is under common control with the member;

(2) "promoter" means any person who founded or organized the business or enterprise of an issuer, is a director or employee of an issuer, acts or has acted as a consultant, advisor, accountant or attorney to an issuer, is the beneficial owner of any of an issuer's securities that are considered "restricted securities" under Rule 144, or is the beneficial owner of five percent (5%) or more of the public float of any class of an issuer's securities, and any other person with a similar interest in promoting the entry of quotations or market making in an issuer's securities; and

(3) "quotation" shall mean any bid or offer at a specified price with respect to a security, or any indication of interest by a member in receiving bids or offers from others for a security, or an indication by a member that he or she wishes to advertise his or her general interest in buying or selling a particular security.

## **2500. SPECIAL ACCOUNTS**

### **2510. Discretionary Accounts**

#### **(a) Excessive Transactions**

No member shall effect with or for any customer's account in respect to which such member or his or her agent or employee is vested with any discretionary power any transactions of purchase or sale which are excessive in size or frequency in view of the financial resources and character of such account.

#### **(b) Authorization and Acceptance of Account**

No member or registered representative shall exercise any discretionary power in a customer's account unless such customer has given prior written authorization to a stated individual or individuals and the account has been accepted by the member, as

evidenced in writing by the member or the partner, officer or manager, duly designated by the member, in accordance with Rule 3010.

**(c) Approval and Review of Transactions**

The member or the person duly designated shall approve promptly in writing each discretionary order entered and shall review all discretionary accounts at frequent intervals in order to detect and prevent transactions which are excessive in size or frequency in view of the financial resources and character of the account.

**(d) Exceptions**

This Rule shall not apply to:

(1) discretion as to the price at which or the time when an order given by a customer for the purchase or sale of a definite amount of a specified security shall be executed;

(2) bulk exchanges at net asset value of money market mutual funds ("funds") utilizing negative response letters provided:

(A) The bulk exchange is limited to situations involving mergers and acquisitions of funds, changes of clearing members and exchanges of funds used in sweep accounts;

(B) The negative response letter contains a tabular comparison of the nature and amount of the fees charged by each fund;

(C) The negative response letter contains a comparative description of the investment objectives of each fund and a prospectus of the fund to be purchased; and

(D) The negative response feature will not be activated until at least 30 days after the date on which the letter was mailed.

Selected NASD Notices to Members: 93-1.

**2520. Margin**

(a) A member shall comply with the initial and maintenance margin requirements of Regulation T and the self-regulatory organization to which the member is designated for oversight pursuant to SEC Rules 17d-1 or 17d-2. Members shall comply with Regulation T and such self-regulatory organization rules as though said rules were part of Nasdaq's rules.

(b) A member designated to Nasdaq for oversight pursuant to SEC Rule 17d-1 or 17d-2 shall comply with the initial and maintenance margin requirements of Regulation T

and the NASD. Members shall comply with Regulation T and the NASD margin rules as though said rules were part Nasdaq's rules.

**2600. RESERVED**

**2700. RESERVED**

**2800. Special Products**

**2810. Direct Participation Programs**

**(a) Definitions**

For the purposes of this Rule, the following terms shall have the stated meanings:

(1) Affiliate--when used with respect to a Nasdaq member or sponsor, shall mean any person which controls, is controlled by, or is under common control with, such Nasdaq member or sponsor and includes:

(A) any partner, officer or director (or person performing similar functions) of (i) such Nasdaq member or sponsor, or (ii) a person which beneficially owns 50% or more of the equity interest in, or has the power to vote 50% or more of the voting interest in, such Nasdaq member or sponsor;

(B) any person which beneficially owns or has the right to acquire 10% or more of the equity interest in or has the power to vote 10% or more of the voting interest in (i) such Nasdaq member or sponsor, or (ii) a person which beneficially owns 50% or more of the equity interest in, or has the power to vote 50% or more of the voting interest in, such Nasdaq member or sponsor;

(C) any person with respect to which such Nasdaq member or sponsor, the persons specified in subparagraph (A) or (B), and the immediate families of partners, officers or directors (or persons performing similar functions) specified in subparagraph (A), or other person specified in subparagraph (B), in the aggregate beneficially own or have the right to acquire 10% or more of the equity interest or have the power to vote 10% or more of the voting interest;

(D) any person an officer of which is also a person specified in subparagraph (A) or (B) and any person a majority of the board of directors of which is comprised of persons specified in subparagraph (A) or (B); or

(E) any person controlled by a person or persons specified in

subparagraphs (A), (B), (C), or (D).

(2) Cash available for distribution--cash flow less amount set aside for restoration or creation of reserves.

(3) Cash flow--cash funds provided from operations, including lease payments on net leases from builders and sellers, without deduction for depreciation, but after deducting cash funds used to pay all other expenses, debt payments, capital improvements and replacements.

(4) Direct participation program (program)--a program which provides for flow-through tax consequences regardless of the structure of the legal entity or vehicle for distribution including, but not limited to, oil and gas programs, real estate programs, agricultural programs, cattle programs, condominium securities, Subchapter S corporate offerings and all other programs of a similar nature, regardless of the industry represented by the program, or any combination thereof. A program may be composed of one or more legal entities or programs but when used herein and in any rules or regulations adopted pursuant hereto the term shall mean each of the separate entities or programs making up the overall program and/or the overall program itself. Excluded from this definition are real estate investment trusts, tax qualified pension and profit sharing plans pursuant to Sections 401 and 403(a) of the Internal Revenue Code and individual retirement plans under Section 408 of that Code, tax sheltered annuities pursuant to the provisions of Section 403(b) of the Internal Revenue Code, and any company including separate accounts, registered pursuant to the Investment Company Act of 1940.

(5) Dissenting limited partner--a person who, on the date on which soliciting material is mailed to investors, is a holder of a beneficial interest in a limited partnership that is the subject of a limited partnership rollup transaction, and who casts a vote against the transaction and complies with procedures established by Nasdaq, except that for purposes of an exchange or tender offer, such person shall file an objection in writing under the Nasdaq Rules during the period in which the offer is outstanding. Such objection in writing shall be filed with the party responsible for tabulating the votes or tenders.

(6) Equity interest--when used with respect to a corporation, means common stock and any security convertible into, exchangeable or exercisable for common stock, and, when used with respect to a partnership, means an interest in the capital or profits or losses of the partnership.

(7) Fair market net worth--total assets computed at fair market value less total liabilities.

(8) Limited partner or investor in a limited partnership--the purchaser of

an interest in a direct participation program that is a limited partnership who is not involved in the day-to-day management of the limited partnership and bears limited liability.

(9) Limited partnership--an unincorporated association that is a direct participation program organized as a limited partnership whose partners are one or more general partners and one or more limited partners, which conforms to the provisions of the Revised Uniform Limited Partnership Act or the applicable statute that regulates the organization of such partnership.

(10) Limited partnership rollup transaction--a transaction involving the combination or reorganization of one or more limited partnerships, directly or indirectly, in which:

(A) some or all of the investors in any of such limited partnerships will receive new securities, or securities in another entity, that will be reported under a transaction reporting plan declared effective before January 1, 1991, by the Commission under Section 11A of the Act.<sup>vi\*</sup>

(B) any of the investors' limited partnership securities are not, as of the date of the filing, reported under a transaction reporting plan declared effective before January 1, 1991, by the Commission under Section 11A of the Act.<sup>vii\*\*</sup>

(C) investors in any of the limited partnerships involved in the transaction are subject to a significant adverse change with respect to voting rights, the term of existence of the entity, management compensation, or investment objectives; and

(D) any of such investors are not provided an option to receive or retain a security under substantially the same terms and conditions as the original issue. Notwithstanding the foregoing definition, a "limited partnership rollup transaction" does not include:

(i) a transaction that involves only a limited partnership or partnerships having an operating policy or practice of retaining cash available for distribution and reinvesting proceeds from the sale, financing, or refinancing of assets in accordance with such criteria as the Commission determines appropriate;

(ii) a transaction involving only limited partnerships wherein the interests of the limited partners are repurchased, recalled or exchanged pursuant to the terms of the pre-existing limited partnership agreements for securities in an operating company specifically identified at the time of the formation of the

original limited partnership;

(iii) a transaction in which the securities to be issued or exchanged are not required to be and are not registered under the Securities Act of 1933;

(iv) a transaction that involves only issuers that are not required to register or report under Section 12 of the Act, both before and after the transaction;

(v) a transaction, except as the Commission may otherwise provide for by rule for the protection of investors, involving the combination or reorganization of one or more limited partnerships in which a non-affiliated party succeeds to the interests of the general partner or sponsor, if:

a. such action is approved by not less than 66 2/3 percent of the outstanding units of each of the participating limited partnerships; and

b. as a result of the transaction, the existing general partners will receive only compensation to which they are entitled as expressly provided for in the pre-existing partnership agreements; or

(vi) a transaction, except as the Commission may otherwise provide for by rule for the protection of investors, in which the securities offered to investors are securities of another entity that are reported under a transaction reporting plan declared effective before January 1, 1991, by the Commission under Section 11A of the Act;<sup>viii\*</sup> if:

a. such other entity was formed, and such class of securities was reported and regularly traded, not less than 12 months before the date on which soliciting material is mailed to investors; and

b. the securities of that entity issued to investors in the transaction do not exceed 20 percent of the total outstanding securities of the entity, exclusive of any securities of such class held by or for the account of the entity or a subsidiary of the entity.

(vii) a transaction involving only entities registered under the Investment Company Act of 1940 or any Business Development Company as defined in Section 2(a)(48) of that Act.

(11) Management fee--a fee paid to the sponsor, general partner(s), their affiliates, or other persons for management and administration of a direct participation program.

(12) Organization and offering expenses--expenses incurred in preparing a direct participation program for registration and subsequently offering interests in the program to the public, including all forms of compensation paid to underwriters, broker/dealers, or affiliates thereof in connection with the offering of the program.

(13) Participant--the purchaser of an interest in a direct participation program.

(14) Person--any natural person, partnership, corporation, association or other legal entity.

(15) Prospectus--a prospectus as defined by Section 2(10) of the Securities Act of 1933, as amended, an offering circular as described in SEC Rule 256 under the Securities Act of 1933, or, in the case of an intrastate offering, any document utilized for the purpose of announcing the offer and sale of securities to the public.

(16) Registration statement--a registration statement as defined by Section 2(8) of the Securities Act of 1933, as amended, a notification on Form 1-A filed with the Commission pursuant to the provisions of SEC Rule 255 under the Securities Act of 1933 and, in the case of an intrastate offering, any document initiating a registration or similar process for an issue of securities which is required to be filed by the laws or regulations of any state.

(17) Solicitation expenses--direct marketing expenses incurred by a Nasdaq member, in connection with a limited partnership rollup transaction such as telephone calls, broker/dealer fact sheets, Nasdaq members' legal and other fees related to the solicitation, as well as direct solicitation compensation to Nasdaq members.

(18) Sponsor--a person who directly or indirectly provides management services for a direct participation program whether as general partner, pursuant to contract or otherwise.

(19) Transaction costs--costs incurred in connection with a limited partnership rollup transaction, including printing and mailing the proxy, prospectus or other documents; legal fees not related to the solicitation of votes or tenders; financial advisory fees; investment banking fees; appraisal fees; accounting fees; independent committee expenses; travel expenses; and all other

fees related to the preparatory work of the transaction, but not including costs that would have otherwise been incurred by the subject limited partnerships in the ordinary course of business or solicitation expenses.

**(b) Requirements**

**(1) Application**

No Nasdaq member or person associated with a Nasdaq member shall participate in a public offering of a direct participation program or a limited partnership rollup transaction except in accordance with this paragraph (b).

**(2) Suitability**

(A) A Nasdaq member or person associated with a Nasdaq member shall not underwrite or participate in a public offering of a direct participation program unless standards of suitability have been established by the program for participants therein and such standards are fully disclosed in the prospectus and are consistent with the provisions of subparagraph (B).

(B) In recommending to a participant the purchase, sale or exchange of an interest in a direct participation program, a Nasdaq member or person associated with a Nasdaq member shall:

(i) have reasonable grounds to believe, on the basis of information obtained from the participant concerning his investment objectives, other investments, financial situation and needs, and any other information known by the Nasdaq member or associated person, that:

a. the participant is or will be in a financial position appropriate to enable him to realize to a significant extent the benefits described in the prospectus, including the tax benefits where they are a significant aspect of the program;

b. the participant has a fair market net worth sufficient to sustain the risks inherent in the program, including loss of investment and lack of liquidity; and

c. the program is otherwise suitable for the participant; and

(ii) maintain in the files of the Nasdaq member documents

disclosing the basis upon which the determination of suitability was reached as to each participant.

(C) Notwithstanding the provisions of subparagraphs (A) and (B) hereof, no Nasdaq member shall execute any transaction in direct participation program in a discretionary account without prior written approval of the transaction by the customer.

(D) Subparagraphs (A) and (B), and, only in situations where the Nasdaq member is not affiliated with the direct participation program, subparagraph (C) shall not apply to:

(i) a secondary public offering of or a secondary market transaction in a unit, depositary receipt, or other interest in a direct participation program for which quotations are displayed on Nasdaq or which is listed on a registered national securities exchange; or

(ii) an initial public offering of a unit, depositary receipt or other interest in a direct participation program for which an application for inclusion on Nasdaq or listing on a registered national securities exchange has been approved by Nasdaq or such exchange and the applicant makes a good faith representation that it believes such inclusion on Nasdaq or listing on an exchange will occur within a reasonable period of time following the formation of the program.

### **(3) Disclosure**

(A) Prior to participating in a public offering of a direct participation program, a Nasdaq member or person associated with a Nasdaq member shall have reasonable grounds to believe, based on information made available to him by the sponsor through a prospectus or other materials, that all material facts are adequately and accurately disclosed and provide a basis for evaluating the program.

(B) In determining the adequacy of disclosed facts pursuant to subparagraph (A) hereof, a Nasdaq member or person associated with a Nasdaq member shall obtain information on material facts relating at a minimum to the following, if relevant in view of the nature of the program:

(i) items of compensation;

(ii) physical properties;

- (iii) tax aspects;
- (iv) financial stability and experience of the sponsor;
- (v) the program's conflict and risk factors; and
- (vi) appraisals and other pertinent reports.

(C) For purposes of subparagraphs (A) or (B) hereof, a Nasdaq member or person associated with a Nasdaq member may rely upon the results of an inquiry conducted by another Nasdaq member or members, provided that:

(i) the Nasdaq member or person associated with a Nasdaq member has reasonable grounds to believe that such inquiry was conducted with due care;

(ii) the results of the inquiry were provided to the Nasdaq member or person associated with a Nasdaq member with the consent of the Nasdaq member or members conducting or directing the inquiry; and

(iii) no Nasdaq member that participated in the inquiry is a sponsor of the program or an affiliate of such sponsor.

(D) Prior to executing a purchase transaction in a direct participation program, a Nasdaq member or person associated with a Nasdaq member shall inform the prospective participant of all pertinent facts relating to the liquidity and marketability of the program during the term of the investment; provided, however, that paragraph (b) shall not apply to an initial or secondary public offering of or a secondary market transaction in a unit, depositary receipt or other interest in a direct participation program which complies with subparagraph (2)(D).

#### **(4) Organization and Offering Expenses**

(A) No Nasdaq member or person associated with a Nasdaq member shall underwrite or participate in a public offering of a direct participation program if the organization and offering expenses are not fair and reasonable, taking into consideration all relevant factors.

(B) In determining the fairness and reasonableness of organization and offering expenses for purposes of subparagraph (A) hereof, the arrangements shall be presumed to be unfair and unreasonable if:

- (i) the total amount of all items of compensation from

whatever source payable to underwriters, broker/dealers, or affiliates thereof, which are deemed to be in connection with or related to the distribution of the public offering, exceeds currently effective compensation guidelines for direct participation programs published by Nasdaq;<sup>ix\*</sup>

(ii) organization and offering expenses paid by a program in which a Nasdaq member or an affiliate of a Nasdaq member is a sponsor exceed currently effective guidelines for such expenses published by Nasdaq;<sup>x\*\*</sup>

(iii) any compensation in connection with an offering is to be paid to underwriters, broker/dealers, or affiliates thereof out of the proceeds of the offering prior to the release of such proceeds from escrow, provided, however, that any such payment from sources other than proceeds of the offering shall be made only on the basis of bona fide transactions;

(iv) commissions or other compensation are to be paid or awarded either directly or indirectly, to any person engaged by a potential investor for investment advice as an inducement to such advisor to advise the purchaser of interests in a particular program, unless such person is a registered broker/dealer or a person associated with such a broker/dealer; or

(v) the program provides for compensation of an indeterminate nature to be paid to Nasdaq members or persons associated with Nasdaq members for sales of program units, or for services of any kind rendered in connection with or related to the distribution thereof, including, but not necessarily limited to, the following: a percentage of the management fee, a profit sharing arrangement, brokerage commissions, and over-riding royalty interest, a net profits interest, a percentage of revenues, a reversionary interest, a working interest, a security or right to acquire a security having an indeterminate value, or other similar incentive items; provided however, that an arrangement which provides for continuing compensation to a Nasdaq member or person associated with a Nasdaq member in connection with a public offering shall not be presumed to be unfair and unreasonable if all of the following conditions are satisfied:

a. the continuing compensation is to be received only after each investor in the program has received cash distributions from the program aggregating an amount equal to his cash investment plus a six percent cumulative

annual return on his adjusted investment;

b. the continuing compensation is to be calculated as a percentage of program cash distributions;

c. the amount of continuing compensation does not exceed three percent for each one percentage point that the total of all compensation pursuant to subparagraph (B)(i) received at the time of the offering and at the time any installment payment is made fall below nine percent; provided, however, that in no event shall the amount of continuing compensation exceed 12 percent of program cash distributions; and

d. if any portion of the continuing compensation is to be derived from the limited partners' interest in the program cash distributions, the percentage of the continuing compensation shall be no greater than the percentage of program cash distributions to which limited partners are entitled at the time of the payment.

(C) All items of compensation paid by the program directly or indirectly from whatever source to underwriters, brokers/dealers, or affiliates thereof, including, but not limited to, sales commissions, wholesaling fees, due diligence expenses, other underwriter's expenses, underwriter's counsel's fees, securities or rights to acquire securities, rights of first refusal, consulting fees, finder's fees, investor relations fees, and any other items of compensation for services of any kind or description, which are deemed to be in connection with or related to the public offering, shall be taken into consideration in computing the amount of compensation for purposes of determining compliance with the provisions of subparagraphs (A) and (B).

(D) The determination of whether compensation paid to underwriters, broker/dealers, or affiliates thereof is in connection with or related to a public offering, for purposes of this subparagraph (4), shall be made on the basis of such factors as the timing of the transaction, the consideration rendered, the investment risk, and the role of the Nasdaq member or affiliate in the organization, management and direction of the enterprise in which the sponsor is involved.

(i) An affiliate of a Nasdaq member which acts or proposes to act as a general partner, associate general partner, or other sponsor of a program shall be presumed to be bearing investment risk for purposes of this paragraph (b) if the affiliate:

a. is subject to potential liability as a general partner to the same extent as any other general partner;

b. is not indemnified against potential liability as a general partner to any greater or different extent than any other general partner for its actions or those of any other general partner;

c. has a net worth equal to at least five percent of the net proceeds of the public offering or \$1.0 million, whichever is less; provided, however, that the computation of the net worth shall not include an interest in the program offered but may include net worth applied to satisfy the requirements of this paragraph (b) with respect to other programs; and

d. agrees to maintain net worth as required by subparagraph c. above under its control until the earlier of the removal or withdrawal of the affiliate as a general partner, associate general partner, or other sponsor, or the dissolution of the program.

(ii) For purposes of determining the factors to be utilized in computing compensation derived from securities received in connection with a public offering, the guidelines set forth in Rule 2710 shall govern to the extent applicable.

(E) No Nasdaq member or person associated with a Nasdaq member shall directly or indirectly accept any non-cash compensation or sales incentive item including, but not limited to, travel bonuses, prizes, and awards offered or provided to such Nasdaq member or its associated persons by any sponsor, affiliate of a sponsor or program. Notwithstanding the foregoing, a Nasdaq member may provide non-cash compensation or sales incentive items to its associated persons provided that no sponsor, affiliate of a sponsor or program, including specifically an affiliate of the Nasdaq member, directly or indirectly participates in or contributes to providing such non-cash compensation. Further, this subparagraph shall not prohibit a person associated with a Nasdaq member from accepting any non-cash sales incentive item offered directly to that person by a sponsor, affiliate of a sponsor or program where:

(i) the aggregate value of all such items paid by any sponsor or affiliate of a sponsor to each associated person during any year does not exceed \$100.00;

(ii) the value of all such items to be made available in

connection with an offering is included as compensation to be received in connection with the offering for purposes of subparagraph (B); and

(iii) the proposed payment or transfer of all such items is disclosed in the prospectus or similar offering document.

(F) Subject to the limitations on direct and indirect non-cash compensation provided under subparagraph (E), no Nasdaq member shall accept any cash compensation unless all of the following conditions are satisfied:

(i) all compensation is paid directly to the Nasdaq member in cash and the distribution, if any, of all compensation to the Nasdaq member's associated persons is controlled solely by the Nasdaq member;

(ii) the value of all compensation to be paid in connection with an offering is included as compensation to be received in connection with the offering for purposes of subparagraph (B);

(iii) arrangements relating to the proposed payment of all compensation are disclosed in the prospectus or similar offering document;

(iv) the value of all compensation paid in connection with an offering is reflected on the books and records of the recipient Nasdaq member as compensation received in connection with the offering; and

(v) no compensation paid in connection with an offering is directly or indirectly related to any non-cash compensation or sales incentive items provided by the Nasdaq member to its associated persons.

## **(5) Participation in Rollups**

(A) No Nasdaq member or person associated with a Nasdaq member shall participate in the solicitation of votes or tenders from limited partners in connection with a limited partnership rollup transaction, irrespective of the form of the resulting entity (i.e., a partnership, real estate investment trust or corporation), unless any compensation received by the Nasdaq member:

(i) is payable and equal in amount regardless of whether the limited partner votes affirmatively or negatively in the

proposed limited partnership rollup transaction;

(ii) in the aggregate, does not exceed 2% of the exchange value of the newly-created securities; and

(iii) is paid regardless of whether the limited partners reject the proposed limited partnership rollup transaction.

(B) No Nasdaq member or person associated with a Nasdaq member shall participate in the solicitation of votes or tenders from limited partners in connection with a limited partnership rollup transaction unless the general partner(s) or sponsor(s) proposing the limited partnership rollup transaction agrees to pay all solicitation expenses related to the limited partnership rollup transaction, including all preparatory work related thereto, in the event the limited partnership rollup transaction is rejected.

(C) No Nasdaq member or person associated with a Nasdaq member shall participate in any capacity in a limited partnership rollup transaction if the transaction is unfair or unreasonable.

(i) A limited partnership rollup transaction will be presumed not to be unfair or unreasonable if the limited partnership rollup transaction provides for the right of dissenting limited partners:

a. to receive compensation for their limited partnership units based on an appraisal of the limited partnership assets performed by an independent appraiser unaffiliated with the sponsor or general partner of the program which values the assets as if sold in an orderly manner in a reasonable period of time, plus or minus other balance sheet items, and less the cost of sale or refinancing and in a manner consistent with the appropriate industry practice. Compensation to dissenting limited partners of limited partnership rollup transactions may be cash, secured debt instruments, unsecured debt instruments, or freely-tradeable securities; provided, however, that:

1. limited partnership rollup transactions which utilize debt instruments as compensation must provide for a trustee and an indenture to protect the rights of the debt holders and provide a rate of interest equal to at least 120% of the applicable federal rate as determined in accordance with Section 1274 of the Internal Revenue Code of

1986;

2. limited partnership rollup transactions which utilize unsecured debt instruments as compensation, in addition to the requirements of subparagraph 1., must limit total leverage to 70% of the appraised value of the assets;

3. all debt securities must have a term no greater than 8 years and provide for prepayment with 80% of the net proceeds of any sale or refinancing of the assets previously owned by the partnership entitles subject to the limited partnership rollup transaction or any part thereof; and

4. freely-tradeable securities utilized as compensation to dissenting limited partners must be previously listed on a national securities exchange or previously traded on Nasdaq prior to the limited partnership rollup transaction, and the number of securities to be received in return for limited partnership interests must be determined in relation to the average last sale price of the freely-tradeable securities in the 20-day period following the date of the meeting at which the vote on the limited partnership rollup transaction occurs. If the issuer of the freely-tradeable securities is affiliated with the sponsor or general partner, newly issued securities to be utilized as compensation to dissenting limited partners shall not represent more than 20 percent of the issued and outstanding shares of that class of securities after giving effect to the issuance. For purposes of the preceding sentence, a sponsor or general partner is "affiliated" with the issuer of the freely-tradeable securities if the sponsor or general partner receives any material compensation from the issuer or its affiliates in conjunction with the limited partnership rollup transaction or the purchase of the general partner's interest; provided, however, that nothing herein shall restrict the ability of a sponsor or general partner to receive any payment for its equity interests and compensation as otherwise provided by this subparagraph.

b. to receive or retain a security with substantially the same terms and conditions as the security originally held. Securities received or retained will be considered to have the same terms and conditions as the security originally held if:

1. there is no material adverse change to dissenting limited partners' rights with respect to the business plan or the investment, distribution and liquidation policies of the limited partnership; and

2. the dissenting limited partners receive substantially the same rights, preferences and priorities as they had pursuant to the security originally held; or

c. to receive other comparable rights including, but not limited to:

1. approval of the limited partnership rollup transaction by 75% of the outstanding units of each of the individual participating limited partnerships and the exclusion of any individual limited partnership from the limited partnership rollup transaction which fails to reach the 75% threshold. The third-party appointed to tabulate votes and dissents pursuant to subparagraph (C)(ii)b.4. hereof shall submit the results of such tabulation to Nasdaq;

2. review of the limited partnership rollup transaction by an independent committee of persons not affiliated with the general partner(s) or sponsor. Whenever utilized, the independent committee:

A. shall be approved by a majority of the outstanding securities of each of the participating partnerships;

B. shall have access to the books and records of the partnerships;

C. shall prepare a report to the limited partners subject to the limited partnership rollup transaction that presents

its findings and recommendations, including any minority views;

D. shall have the authority to negotiate the proposed transaction with the general partner or sponsor on behalf of the limited partners, but not the authority to approve the transaction on behalf of the limited partners;

E. shall not deliberate for a period longer than 60 days, although extensions will be permitted if unanimously agreed upon by the members of the independent committee or if approved by Nasdaq;

F. may be compensated and reimbursed by the limited partnerships subject to the limited partnership rollup transaction and shall have the ability to retain independent counsel and financial advisors to represent all limited partners at the limited partnerships' expense provided the fees are reasonable; and

G. shall be entitled to indemnification to the maximum extent permitted by law from the limited partnerships subject to the limited partnership rollup transaction from claims, causes of action or lawsuits related to any action or decision made in furtherance of their responsibilities; provided, however, that general partners or sponsors may also agree to indemnify the independent committee; or

3. any other comparable rights for dissenting limited partners proposed by general partners or sponsors, provided, however, that the general partner(s) or sponsor demonstrates to the satisfaction of Nasdaq or, if Nasdaq determines appropriate, to the satisfaction of an independent committee, that the rights proposed are comparable.

(ii) Regardless of whether a limited partnership rollup

transaction is in compliance with subparagraph (C)(i), a limited partnership rollup transaction will be presumed to be unfair and unreasonable:

a. if the general partner(s):

1. converts an equity interest in any limited partnership(s) subject to a limited partnership rollup transaction for which consideration was not paid and which was not otherwise provided for in the limited partnership agreement and disclosed to limited partners, into a voting interest in the new entity (provided, however, an interest originally obtained in order to comply with the provisions of Internal Revenue Service Revenue Proclamation 89-12 may be converted);

2. fails to follow the valuation provisions, if any, in the limited partnership agreements of the subject limited partnerships when valuing their limited partnership interests; or

3. utilizes a future value of their equity interest in the limited partnership rather than the current value of their equity interest, as determined by an appraisal conducted in a manner consistent with subparagraph (C)(i)a., when determining their interest in the new entity;

b. as to voting rights, if:

1. the voting rights in the entity resulting from a limited partnership rollup transaction do not generally follow the original voting rights of the limited partnerships participating in the limited partnership rollup transaction; provided, however, that changes to voting rights may be effected if Nasdaq determines that such changes are not unfair or if the changes are approved by an independent committee;

2. a majority of the interests in an entity resulting from a limited partnership rollup transaction may not, without concurrence by the sponsor, general partner(s), board of directors, trustee, or similar governing entity, depending on

the form of entity and to the extent not inconsistent with applicable state law, vote to:

A. amend the limited partnership agreement, articles of incorporation or by-laws, or indenture;

B. dissolve the entity;

C. remove the general partner, board of directors, trustee or similar governing entity, and elect a new general partner, board of directors, trustee or similar governing entity; or

D. approve or disapprove the sale of substantially all of the assets of the entity;

3. the general partner(s) or sponsor(s) proposing a limited partnership rollup transaction do not provide each limited partner with a document which instructs the limited partner on the proper procedure for voting against or dissenting from the transaction; or

4. the general partner(s) or sponsor(s) does not utilize an independent third party to receive and tabulate all votes and dissents in connection with the limited partnership rollup transaction, and require that the third party make the tabulation available to the general partner and any limited partner upon request at any time during and after voting occurs;

c. as to transaction costs, if:

1. transaction costs of a rejected limited partnership rollup transaction are not apportioned between general and limited partners of the subject limited partnerships according to the final vote on the proposed transaction as follows:

A. the general partner(s) or sponsor(s) bear all transaction costs in proportion to the total number of abstentions and votes to reject the limited partnership

rollup transaction; and

B. limited partners bear transaction costs in proportion to the number of votes to approve the limited partnership rollup transaction; or

2. individual limited partnerships that do not approve a limited partnership rollup transaction are required to pay any of the transaction costs, and the general partner or sponsor is not required to pay the transaction costs on behalf of the non-approving limited partnerships, in a limited partnership rollup transaction in which one or more limited partnerships determines not to approve the transaction, but where the transaction is consummated with respect to one or more approving limited partnerships; or

d. as to fees of general partners, if:

1. general partners are not prevented from receiving both unearned management fees discounted to a present value (if such fees were not previously provided for in the limited partnership agreement and disclosed to limited partners) and new asset-based fees;

2. property management fees and other general partner fees are inappropriate, unreasonable and more than, or not competitive with, what would be paid to third parties for performing similar services; or

3. changes in fees which are substantial and adverse to limited partners are not approved by an independent committee according to the facts and circumstances of each transaction.

(c) Exemptions. Pursuant to the Rule 9600 Series, Nasdaq may exempt a Nasdaq member or person associated with a Nasdaq member from the provisions this Rule for good cause shown.

Selected NASD Notices to Members: 83-13, 84-28, 84-64, 85-17, 85-29, 86-66, 86-81, 88-88, 89-16, 91-56, 91-78, 93-15, 93-44, 94-24, 94-70, 95-63, 95-64.

## 2900. RESPONSIBILITIES TO OTHER BROKERS OR DEALERS

### 2910. Disclosure of Financial Condition to Other Members

Any member of Nasdaq that is a party to an open transaction or that has on deposit cash or securities of another member shall furnish upon written request of the other member a statement of its financial condition as disclosed in its most recently prepared balance sheet.

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ii For purposes of this Rule, the term "ERISA" is an acronym for the Employee Retirement Income Security Act of 1974.

iii This interpretation does not address the obligation related to suitability that requires that a member ". . . a 'reasonable basis' to believe that the recommendation could be suitable for at least some customers." In the Matter of the Application of F.J. Kaufman and Company of Virginia and Fredrick J. Kaufman, Jr. 50 SEC 164 (1989).

iv "It is the position of the Division of Investment Management of the Commission that compensation received by a member or person associated with a member under this Rule would constitute "special compensation" for purposes of the exception to the definition of "investment advisor" in Section 202(a)(11)(C) of the Investment Advisers Act of 1940 (Advisers Act). Any member or person associated with a member, required to be registered under the Advisers Act, or state law, who receives compensation based on a share of profits or capital appreciation of a customer's account must comply with Section 205(1) and Rule 205-3 under the Advisers Act, or applicable state law, with respect to such compensation. (SEC Release 34-24355. 52 Fed. Reg. 13778, April 24, 1987)."

vi Transaction reporting plans under Section 11A were declared effective prior to January 1, 1991 for the Nasdaq National Market System, the New York Stock Exchange, and the American Stock Exchange.

vii Transaction reporting plans under Section 11A were declared effective prior to January 1, 1991 for the Nasdaq National Market System, the New York Stock Exchange, and the American Stock Exchange.

viii Transaction reporting plans under Section 11A were declared effective prior to January 1, 1991 for the Nasdaq National Market System, the New York Stock Exchange, and the American Stock Exchange.

ix A guideline for underwriting compensation of ten percent of proceeds received, plus a maximum of 0.5% for reimbursement of bona fine due diligence expenses, was published in Notice to Members 82-51 (October 19, 1982).

x A guideline for organization and offering expenses of 15 percent of proceeds received was published in Notice to Members 82-51 (October 19, 1982).